INFLATION REPORT
FOURTH Quarter 2015

BANGKO SENTRAL NG PILIPINAS

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FOREWORD

The primary objective of monetary policy is to promote a low and stable rate of inflation conducive to a balanced and sustainable economic growth. The adoption in January 2002 of the inflation targeting framework for monetary policy was aimed at helping to fulfill this objective.

One of the key features of inflation targeting is greater transparency, which means greater disclosure and communication by the BSP of its policy actions and decisions. This Inflation Report is published by the BSP as part of its transparency mechanisms under inflation targeting. The objectives of this Inflation Report are: (i) to identify the risks to price stability and discuss their implications for monetary policy; and (ii) to document the economic analysis behind the formulation of monetary policy and convey to the public the overall thinking behind the BSP's decisions on monetary policy. The broad aim is to make monetary policy easier for the public to understand and enable them to better monitor the BSP's commitment to the inflation target, thereby helping both in anchoring inflation expectations and encouraging informed debate on monetary policy issues.

The government's target for annual headline inflation under the inflation targeting framework has been set at 3.0 percent ± 1.0 percentage point (ppt) for 2015-2018 by the Development Budget Coordination Committee (DBCC). This is consistent with the desired disinflation path over the medium term, favorable trends in the structure of inflation, and expected higher capacity of the economy for growth under a low inflation environment.

The report is published on a quarterly basis, presenting a survey of the various factors affecting inflation. These include recent price and cost developments, inflation expectations, prospects for aggregate demand and output, labor market conditions, monetary and financial market conditions, fiscal developments, and the international environment. An entire section is devoted to a discussion of monetary policy developments in the most recent quarter, while a separate section provides a comprehensive analysis of the BSP's view of the inflation outlook for the policy horizon.

The Monetary Board approved this Inflation Report at its meeting on 14 January 2016.

AMANDO M. TETANGCO, JR.
Governor

22 January 2016

List of Acronyms, Abbreviations, and Symbols

ABT	Alcoholic Beverages and Tobacco
AL	Auto Loans
BES	Business Expectations Survey
BGC	Bonifacio Global City
BIR	Bureau of Internal Revenue
BOC	Bureau of Customs
BTr	Bureau of the Treasury
CAMPI	Chamber of Automotive Manufacturers of the Philippines, Inc.
CAR	Capital Adequacy Ratio
CBD	Central Business District
CES	Consumer Expectations Survey
CDS	Credit Default Swaps
CI	Confidence Index
COV	Coefficient of Variation
CPI	Consumer Price Index
DBCC	Development Budget Coordination Committee
DOE	Department of Energy
DI	Diffusion Index
DOF	Department of Finance
EIA	US Energy Information Administration
EM	Emerging Market
EMBI	JP Morgan Emerging Market Bond Index
ERC	Energy Regulatory Commission
FAO	Food and Agriculture Organization
FCDA	Foreign Currency Differential Adjustment
GDP	Gross Domestic Product
GNI	Gross National Income
GOUR	Generation over/under-recovery
GS	Government Securities
IEA	International Energy Agency
IMF	International Monetary Fund
IPP	Independent Power Producer
IRI	International Research Institute for Climate and Society
LFS	Labor Force Survey
LPG	Liquefied Petroleum Gas
LSOUR	Lifeline subsidy over/under recovery
LTFRB	Land Transportation Franchising and Regulatory Board
MB	Monetary Board
MEM	Multi-Equation Model
MENA	Middle East and North Africa
Meralco	Manila Electric Company
MISSI	Monthly Integrated Survey of Selected Industries
MTP	Major Trading Partner
NBQBs	Non-Bank Financial Institutions with Quasi-Banking Functions
NDA	Net Domestic Assets
NEDA	National Economic and Development Authority

NEER	Nominal Effective Exchange Rate
NFA	Net Foreign Assets; National Food Authority
NG	National Government
NGCP	National Grid Corporation of the Philippines
NOAA	National Oceanic and Atmospheric Administration
NPC	National Power Corporation
NPI	Net Primary Income
NPLs	Non-performing loans
O&O	Offshoring and Outsourcing
OECD	Organization for Economic Cooperation and Development
OPEC	Organization of the Petroleum Exporting Countries
OF	Overseas Filipinos
PBR	Performance-Based Rate
PMI	Purchasing Managers' Index
PSA	Philippine Statistics Authority; Power Supply Agreement
PSALM	Power Sector Assets and Liabilities Management Corporation
PSEi	Philippine Stock Exchange Composite Index
RB	Rural Banks
RDA	Reserve Deposit Account
REER	Real Effective Exchange Rate
ROP	Republic of the Philippines
RP	Repurchase
RR	Reserve Requirement
RREL	Residential and Real Estate Loans
RRP	Reverse Repurchase
RWAs	Risk Weighted Assets
SDA	Special Deposit Account
SEM	Single-Equation Model
SLOUR	System loss over/under-recovery
SMEs	Small and Medium Enterprises
SOFSM	Society of Fellows in Supply Management, Inc.
TLP	Total Loan Portfolio
TOUR	Transmission over/under-recovery
U/KBs	Universal/commercial banks
VAPI	Value of production index
VOPI	Volume of production index
WEO	World Economic Outlook
WESM	Wholesale Electricity Spot Market
WTI	West Texas Intermediate

THE MONETARY POLICY OF THE BANGKO SENTRAL NG PILIPINAS

The BSP Mandate

The BSP's main responsibility is to formulate and implement policy in the areas of money, banking and credit, with the primary objective of maintaining stable prices conducive to a balanced and sustainable economic growth in the Philippines. The BSP also aims to promote and preserve monetary stability and the convertibility of the national currency.

Monetary Policy Instruments

The BSP's primary monetary policy instrument is its overnight reverse repurchase (RRP) or borrowing rate. Other instruments to implement the desired monetary policy stance to achieve the inflation target include (a) increasing/decreasing the reserve requirement; (b) encouraging/discouraging deposits in the special deposit account (SDA) facility by banks and trust entities of BSP-supervised financial institutions; (c) adjusting the rediscount rate on loans extended to banking institutions on a short-term basis against eligible collateral of banks' borrowers; and (d) outright sales/purchases of the BSP's holdings of government securities.

Policy Target

The BSP's target for monetary policy uses the Consumer Price Index (CPI) or headline inflation rate, which is compiled and released to the public by the National Statistics Office (NSO). The policy target is set by the Development Budget Coordination Committee (DBCC)[1] in consultation with the BSP. The inflation target for 2015-2018 is 3.0 percent ± 1.0 ppt.[2]

BSP's Explanation Clauses

These are the predefined set of acceptable circumstances under which an inflation-targeting central bank may fail to achieve its inflation target. These clauses reflect the fact that there are limits to the effectiveness of monetary policy and that deviations from the inflation target may sometimes occur because of factors beyond the control of the central bank. Under the inflation targeting framework of the BSP, these exemptions include inflation pressures arising from: (a) volatility in the prices of agricultural products; (b) natural calamities or events that affect a major part of the economy; (c) volatility in the prices of oil products; and (d) significant government policy changes that directly affect prices such as changes in the tax structure, incentives, and subsidies.

[1] The DBCC, created under Executive Order (E.O.) No. 232 dated 14 May 1970, is an inter-agency committee tasked primarily to formulate the National Government's fiscal program. It is composed of the Office of the President (OP), Department of Budget and Management (DBM), National Economic and Development Authority (NEDA), and the Department of Finance (DOF). The BSP attends the Committee meetings as a resource agency.

[2] The inflation range target for 2015-2018 was announced thru DBCC Resolution No.2015-1 dated 27 January 2015. The decision to maintain the inflation range target for 2016-2018 was announced thru DBCC Resolution No.2015-7 dated 29 December 2015.

The Monetary Board

The powers and functions of the BSP, such as the conduct of monetary policy and the supervision over the banking system, are exercised by its Monetary Board, which has seven members appointed by the President of the Philippines. The Monetary Board holds eight (8) monetary policy meetings in a year to review and decide on the stance of monetary policy.

Chairman	Amando M. Tetangco, Jr.
Members	Cesar V. Purisima
	Alfredo C. Antonio
	Felipe M. Medalla
	Armando L. Suratos
	Juan D. De Zuñiga, Jr.
	Valentin A. Araneta

The Advisory Committee

The Advisory Committee was established as an integral part of the institutional setting for inflation targeting. It is tasked to deliberate, discuss, and make recommendations on monetary policy to the Monetary Board. Like the Monetary Board, the Committee meets eight times a year but may also meet between regular meetings, whenever deemed necessary.

Chairman	Amando M. Tetangco, Jr. Governor
Members	Diwa C. Guinigundo Deputy Governor Monetary Stability Sector
	Nestor A. Espenilla, Jr. Deputy Governor Supervision and Examination Sector
	Ma. Ramona GDT Santiago Assistant Governor Treasury Department
	Francisco G. Dakila, Jr. Managing Director Monetary Policy Sub-sector

SCHEDULE OF MONETARY POLICY MEETINGS, INFLATION REPORT PRESS CONFERENCE AND PUBLICATION OF MB HIGHLIGHTS					
Period		**Advisory Committee (AC) Meeting**	**Monetary Board (MB) Meeting**	**MB Highlights Publication**	**Inflation Report (IR) Press Conference**
2015	Oct			22 (Thu) (24 Sep 2015 MB meeting)	23 (Fri) (Q3 2015 IR)
	Nov	6 (Fri) (AC Meeting No. 7)	12 (Thu) (MB Meeting No. 7)		
	Dec	11 (Fri) (AC Meeting No. 8)	17 (Thu) (MB Meeting No. 8)	10 (Thu) (12 Nov 2015 MB meeting)	
2016	Jan			14 (Thu) (17 Dec 2015 MB meeting)	22 (Fri) (Q4 2015 IR)
	Feb	5 (Fri) (AC Meeting No. 1)	11 (Thu) (MB Meeting No. 1)		
	Mar	18 (Fri) (AC Meeting No. 2)	23 (Wed) (MB Meeting No. 2)	10 (Thu) (11 Feb 2016 MB meeting)	
	Apr			21 (Thu) (23 Mar 2016 MB meeting)	22 (Fri) (Q1 2016 IR)
	May	6 (Fri) (AC Meeting No. 3)	12 (Thu) (MB Meeting No. 3)		
	Jun	17 (Fri) (AC Meeting No. 4)	23 (Thu) (MB Meeting No. 4)	9 (Thu) (12 May 2016 MB meeting)	
	Jul			21 (Thu) (23 Jun 2016 MB meeting)	22 (Fri) (Q2 2016 IR)
	Aug	5 (Fri) (AC Meeting No. 5)	11 (Thu) (MB Meeting No. 5)		
	Sep	16 (Fri) (AC Meeting No. 6)	22 (Thu) (MB Meeting No. 6)	8 (Thu) (11 Aug 2016 MB meeting)	
	Oct			20 (Thu) (22 Sep 2016 MB meeting)	21 (Fri) (Q3 2016 IR)
	Nov	4 (Fri) (AC Meeting No. 7)	10 (Thu) (MB Meeting No. 7)		
	Dec	16 (Fri) (AC Meeting No. 8)	22 (Thu) (MB Meeting No. 8)	8 (Thu) (10 Nov 2016 MB meeting)	

Contents

OVERVIEW

Inflation settled below the 2015 target range. Headline inflation edged higher in Q4 2015 to 1.0 percent from the quarter-ago average of 0.6 percent. This brought the full-year average inflation rate to 1.4 percent which is below the Government's inflation range target of 3.0 percent ± 1.0 percentage point for 2015. Easing petroleum prices and ample food supply contributed largely to the low inflation readings during the year. Nevertheless, inflation gained momentum in the fourth quarter of the year, traced mainly to seasonal demand for certain food items as well as the adverse impact of recent typhoons on food supply. Non-food inflation likewise inched higher owing in part to passenger fare increases for air and sea transport. Meanwhile, core inflation increased slightly to 1.8 percent from 1.6 percent in the previous quarter. In terms of the alternative measures of core inflation estimated by the BSP, only the weighted median showed a slight uptick while the other two measures remained steady. Meanwhile, the number of items with inflation rates greater than the upper end of the 2015 inflation target increased to 23 items in Q4 2015 from 22 items in the previous quarter, comprising a slightly higher share of the CPI basket.

Inflation expectations are generally lower. Results of the BSP's survey of private sector economists for December 2015 yielded lower mean inflation forecasts for 2015-2017 relative to the results in September 2015. The analysts attributed their lower inflation expectations mainly to lower global oil prices as well as domestic utility rates which are seen to outweigh upside risks coming from adverse climate and weather conditions, election-related expenditures, holiday spending, peso depreciation and possible adjustments in utility rates. Similarly, results of the December 2015 Consensus Economics survey also showed lower inflation forecasts for 2015 and 2016 at 1.4 percent and 2.5 percent, respectively.

Prospects for domestic demand remain intact. Domestic economic growth was brisker in Q3 2015 at 6.0 percent relative to the quarter-ago and year-ago rates of 5.8 percent and 5.5 percent, respectively. Accelerated consumer and government spending, and increasing fixed capital investments, particularly in durable equipment and public construction supported Q3 economic activity. In addition, trends in higher-frequency demand indicators point to positive growth momentum in the near term. Vehicle sales sustained its double-digit growth on continued marketing efforts and attractive financing programs, while the composite Purchasing Managers' Index remained above the 50-point expansion threshold. Business and consumer confidence sustained an optimistic outlook, supporting the view that underlying domestic demand remains firm amid sustained credit growth and notable improvements in employment conditions.

Global economic prospects soften on slowdown in emerging markets. Economic activity in the advanced economies stayed firm, underscored by a solid recovery in the US, Japan and euro area. By contrast, downturns were noted in major emerging markets such as China, Brazil and Russia. The subdued economic outlook for emerging markets dampened global growth prospects to which a number of central banks responded by easing their monetary policy settings to support domestic economic activity and stave off deflationary pressures.

Domestic financial market conditions remain sound despite external uncertainties. The domestic financial system remained stable, supported by strong macroeconomic fundamentals during the review quarter. However, external headwinds emanating from a weak global economic outlook, due in part to continued weakness in China, and uncertainty related to the US interest rate lift-off have contributed to episodes of risk-off sentiments. The Philippine equities market saw dampened activity during the review period, as gains were offset partially by episodes of volatility.

Bond spreads and risk premiums likewise reflected the gyrations in the global markets. Nevertheless, the country's sovereign CDS remained lower compared to its Asian neighbors. Investor appetite for local currency government securities remained healthy, affirmed by the continued oversubscription in the scheduled GS auctions. Moreover, the banking system remained sound and resilient, marked by sustained growth in assets, lending, and deposits, and with capital adequacy ratios comfortably above the BSP's and Bank for International Settlements' prescribed levels. In addition, bank lending standards for both loans to enterprises and household were also broadly unchanged during the quarter, indicating that banks continue to prudently manage their risks.

The BSP maintains monetary policy settings in 2015. The BSP decided to maintain its key policy interest rates at 4.0 percent for the overnight borrowing or RRP facility and 6.0 percent for the overnight lending or RP facility. The interest rates on term RRPs, RPs, and SDAs were also kept steady. The reserve requirement ratios were left unchanged as well. These policy decisions were based on the BSP's assessment of the dynamics and risks in the inflation environment over the policy horizon. The potential impact of the recent monetary policy adjustment in the US on global financial conditions was also considered. The authorities were of the view that amid a benign inflation outlook, domestic growth fundamentals remain intact and are expected to accelerate going forward.

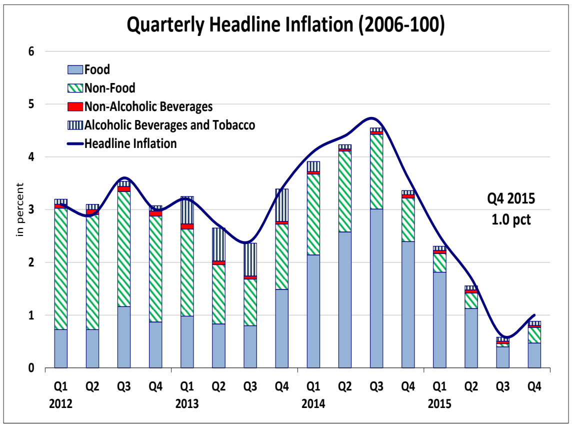
Current monetary policy settings remain appropriate in view of the emerging outlook for inflation and demand conditions. **Latest baseline forecasts show that inflation will return gradually to a target-consistent path over the policy horizon.** Notwithstanding the below-target inflation for 2015, inflation dynamics are expected to continue to gather momentum in 2016 but should remain manageable given well-contained inflation expectations over the policy horizon. Moreover, latest baseline inflation forecasts for 2017 show that annual average inflation is also likely to settle within the target range. Nevertheless, the BSP's review of current price trends suggests that there continue to be risks surrounding the inflation outlook. Pending petitions for power rate adjustments and the impact of prolonged El Niño dry weather conditions on food prices and utility rates represent the main upside risks to inflation. Meanwhile, the on-going weakness in the global economy serves as the key downside risk to inflation.

Firm demand-side conditions also support the view that current monetary policy settings are appropriately calibrated. Domestic economic activity remains intact and continues to gain momentum. Credit activity and growth in domestic liquidity remains at pace with the overall requirements of the economy. Looking ahead, the evolving expectations about the policy settings of major central banks, outlook for financial and economic conditions in China as well as the possibility of a slower global growth are important considerations for the inflation outlook in the succeeding quarters to the extent that they can influence inflation expectations and market sentiment on the domestic front. Going forward, the BSP will continue to monitor domestic and external developments to ensure that the monetary policy stance remains consistent with its price and financial stability objectives.

I. Inflation and Real Sector Developments

Prices

Inflation gained momentum in Q4 2015 on higher prices of food and service-related items

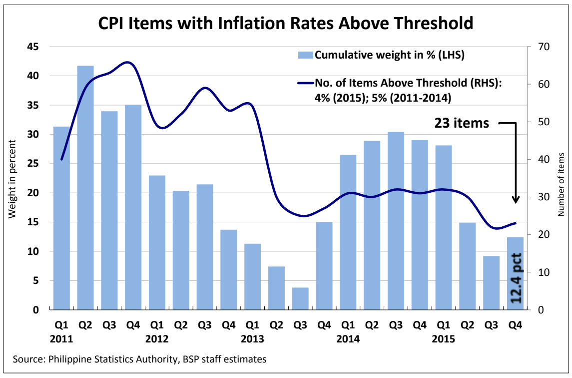


Official core inflation is higher in Q4 2015 while alternative measures are broadly steady

Alternative Core Inflation Measures
quarterly averages of year-on-year change

Quarter	Official Headline Inflation	Official Core Inflation	Trimmed Mean [1]	Weighted Median [2]	Net of Volatile Items [3]
2013	**3.0**	**2.9**	**2.5**	**2.3**	**3.1**
Q1	3.2	3.8	3.0	2.8	3.9
Q2	2.7	2.9	2.3	2.3	3.2
Q3	2.4	2.1	2.1	2.0	2.4
Q4	3.4	2.9	2.6	2.2	2.9
2014	**4.1**	**3.0**	**3.5**	**2.9**	**2.6**
Q1	4.1	3.0	3.3	2.6	2.8
Q2	4.4	3.0	3.6	3.2	2.6
Q3	4.7	3.3	3.8	3.1	2.8
Q4	3.6	2.7	3.3	2.7	2.4
2015	**1.4**	**2.0**	**1.9**	**1.9**	**1.8**
Q1	2.5	2.5	3.0	3.0	2.3
Q2	1.7	2.2	2.1	2.2	1.9
Q3	0.6	1.6	1.3	1.2	1.5
Q4	1.0	1.8	1.3	1.3	1.5

[1] The trimmed mean represents the average inflation rate of the (weighted) middle 70 percent in a lowest-to-highest ranking of year-on-year inflation rates for all CPI components.
[2] The weighted median represents the middle inflation rate (corresponding to a cumulative CPI weight of 50 percent) in a lowest-to-highest ranking of year-on-year inflation rates.
[3] The net of volatile items method excludes the following items: bread and cereals, meat, fish, fruit, vegetables, gas, solid fuels, fuels and lubricants for personal transport equipment, and passenger transport by road, which represents 39.0 percent of all items. The series has been recomputed using a new methodology that is aligned with PSA's method of computing the official core inflation, which re-weights remaining items to comprise 100 percent of the core basket after excluding non-core items. The previous methodology retained the weights of volatile items in the CPI basket while keeping their indices constant at 100.0 from month to month.
Source: Philippine Statistical Authority (PSA), BSP estimates



Source: Philippine Statistics Authority, BSP staff estimates

Headline and Core Inflation

Headline inflation edged higher to 1.0 percent year-on-year (y-o-y) in Q4 2015 from the quarter-ago rate of 0.6 percent but was lower than the year-ago rate of 3.6 percent. This brought the full-year average inflation rate to 1.4 percent, which is below the Government's inflation range target of 3.0 percent ± 1.0 percentage point (ppt) for 2015.

Inflation pressures in Q4 2015 were traced mainly to higher prices of certain food items due to seasonal demand and the adverse impact of recent typhoons that visited the country. Likewise, non-food inflation inched up as prices of service-related CPI components accelerated during the quarter.

Similarly, core inflation—which excludes certain volatile food and energy items to better capture underlying price pressures—was higher in Q4 2015 at 1.8 percent from 1.6 percent in the previous quarter. Meanwhile, of the three alternative measures of core inflation estimated by the BSP, only the weighted median rose slightly to 1.3 percent while the trimmed mean and net of volatile items measures remained steady at 1.3 percent and 1.5 percent, respectively.

The number of items with inflation rates greater than the threshold of 4.0 percent (the upper end of the 2015 inflation target) increased to 23 items in Q4 2015 from 22 items in the previous quarter. These items accounted for 12.4 percent of the CPI basket, higher than the quarter-ago share of 9.2 percent.

Grouping the CPI basket into food and non-food components, the number of food items—which includes alcoholic beverages and tobacco—with inflation rates above the 4.0-percent threshold was slightly lower at 8 items (from 9 items) while non-food items above threshold increased to 15 items (from 13 items).

Food Inflation

Seasonal demand and tight supply from weather-related damages drive food inflation higher in Q4 2015

Food inflation increased in Q4 2015 to 1.3 percent from 1.1 percent in the previous quarter due mainly to recent weather-related supply disruptions and higher demand during the holiday season, which pushed prices of certain food items higher. In particular, retail prices of meat, fish, and vegetables were notably higher in Q4. Meanwhile, rice prices continued to decline relative to year-ago levels as additional rice importation and the onset of the harvest season ensured sufficient supply despite typhoon-related damages in certain crop-producing provinces.[3] Slower price increases were also noted for other food items such as fruit as well as milk, cheese, and eggs.

INFLATION RATES FOR SELECTED FOOD ITEMS
quarterly averages in percent (2006=100)

Commodity	2014	2015			
	Q4	Q1	Q2	Q3	Q4
Food and Non-Alcoholic Beverages	6.3	4.8	3.0	1.1	1.3
Food	6.6	5.0	3.1	1.1	1.3
Bread and Cereals	8.5	5.7	2.6	-0.5	-1.6
Rice	10.4	7.2	3.3	-0.9	-2.5
Corn	6.6	2.4	0.2	-0.6	-0.4
Meat	5.3	4.2	1.3	0.4	0.8
Fish	5.2	5.1	5.3	3.2	3.7
Milk, Cheese and Eggs	4.8	4.4	3.3	1.9	1.3
Oils and Fats	6.2	2.7	0.9	-0.3	-0.2
Fruit	11.0	11.4	9.6	4.9	3.5
Vegetables	3.6	1.1	0.4	0.2	9.0
Sugar, Jam, Honey	5.9	3.8	4.2	2.9	3.9
Food Products, N.E.C.	7.6	4.8	4.6	3.8	2.7
Non-Alcoholic Beverages	2.3	2.1	2.2	1.8	1.4
Alcoholic Beverages and Tobacco	3.9	4.0	3.8	3.7	3.9

Source of Basic Data: PSA, BSP

Similarly, alcoholic beverages and tobacco (ABT) inflation accelerated slightly in Q4 2015 to 3.9 percent from 3.7 percent in the previous quarter. By contrast, non-alcoholic beverages inflation decelerated further in Q4 at 1.4 percent from 1.8 percent in the previous quarter.

Non-food Inflation

Likewise, non-food inflation rises due to transport services

Non-food inflation rose in Q4 2015 to 0.5 percent from 0.1 percent in Q3 2015. The increase was driven primarily by price increases in service-related CPI components namely, hospital and transport services. In particular, fare hikes for passenger transport via air as well as sea and inland waterway drove non-food inflation higher.

INFLATION RATES FOR SELECTED NON-FOOD ITEMS
quarterly averages in percent (2006=100)

Commodity	2014	2015			
	Q4	Q1	Q2	Q3	Q4
Non-Food	1.4	0.6	0.5	0.1	0.5
Clothing and Footwear	3.4	3.1	2.6	2.3	2.3
Housing, Water, Electricity, Gas and Other Fuels	0.4	-1.1	-1.1	-1.7	-1.2
Electricty, Gas, and Other Fuels	-2.7	-8.7	-8.2	-9.8	-8.8
Furnishings, Household Equipment & Routine Maintenance of the House	2.7	2.2	2.1	1.7	1.6
Health	3.4	2.7	2.3	1.7	1.8
Transport	0.0	-0.7	0.0	-0.5	0.9
Transport Services	0.7	2.6	2.9	2.5	3.3
Communication	0.1	-0.1	-0.1	0.0	0.0
Recreation and Culture	1.5	1.1	1.1	1.0	1.0
Education	5.1	5.1	4.7	3.6	3.6
Restaurant and Miscellaneous Goods and Services	1.8	1.6	1.2	1.2	1.3

Source of Basic Data: PSA, BSP

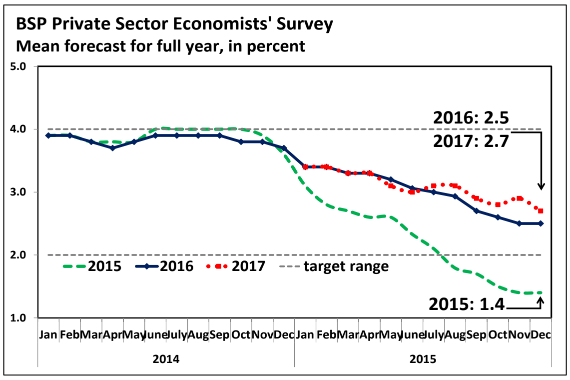
By contrast, electricity, gas, and other fuels continued to decline in Q4 2015 at -8.8 percent (from -9.8 percent) as global oil prices in December 2015 dropped to its lowest level since 2004.[4] This, in turn, triggered a series of domestic petrol rollbacks and downward adjustments in electricity rates owing to lower generation charges from energy suppliers.

Other major non-food commodities such as clothing and footwear, communication, recreation and culture, and lastly, education remained steady in Q4 2015.

[3] The largest rice output losses caused by typhoon *Lando* were noted in northern and central Luzon, particularly Region 3, which reported losses amounting to ₱6.7 billion as of 23 October 2015.
[4] Data from the IMF showed that the crude oil prices—computed as a simple average of the three spot prices namely, (1) dated Brent; (2) WTI; and (3) Dubai Fateh—declined in December 2015 to its lowest since 2004.

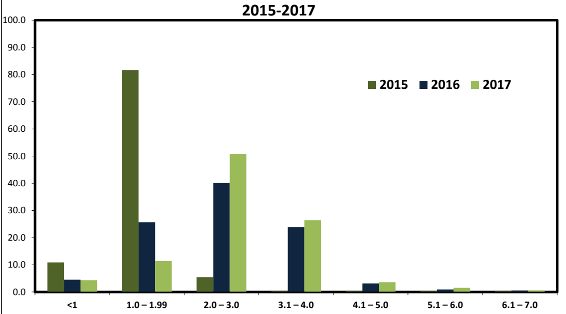
Private Sector Economists' Inflation Forecasts

Mean inflation forecasts for 2015-2017 are lower



PRIVATE SECTOR FORECASTS FOR INFLATION, DECEMBER 2015
annual percent change

	2015	2016			2017
	FY	Q1	Q2	FY	FY
1) Al-Amanah Islamic Bank	1.30	1.10	1.10	1.20	2.00
2) Asia ING Bank	1.40	1.10	1.50	1.60	2.60
3) Banco de Oro	1.40	1.48	1.95	3.20	3.50
4) Bangkok Bank	1.50	1.75	1.75	1.75	2.00
5) Bank of Commerce	0.90	1.40	-	-	-
6) Bank of China	1.40	1.80	2.10	2.50	3.00
7) Bank of the Philippine Islands	1.50	2.20	3.40	3.60	-
8) Chinabank	1.40	3.10	3.10	3.10	3.20
9) CTBC Bank	1.30	-	-	2.50	3.00
10) Citibank, N.A.	1.40	1.00	1.10	1.00	1.70
11) Deutsche Bank	1.40	-	-	3.00	3.10
12) Global Source	1.40	1.90	2.80	2.90	-
13) Korea Exchange Bank	2.90	2.90	2.80	2.80	2.80
14) Land Bank of the Philippines	1.30-1.50	1.40-1.60	1.50-1.70	2.10-2.40	2.10-2.40
15) Maybank	1.43	2.60	3.00	3.00	3.00
16) Metrobank	1.40	-	-	2.70	3.80
17) Multinat'l Inv. Banc	1.40	1.20	1.60	2.00	3.00
18) Mizuho	1.30	1.00	1.20	1.20	1.50
19) Nomura	1.40	1.80	2.30	2.70	3.50
20) RCBC	1.40-1.50	1.50-1.80	1.90-2.60	2.30-2.80	3.00-3.50
21) Robinsons Bank	1.25-1.50	1.25-1.75	1.50-2.00	1.50-2.50	2.00-3.00
22) Security Bank	1.30	1.30	1.50	3.00	3.30
23) Standard Chartered	1.30	1.40	2.00	2.20	2.90
24) UBS	1.40	2.40	3.60	3.50	2.40
25) Union Bank	1.60	2.60	3.20	2.80	2.50
Median Forecast	1.4	1.6	2.0	2.6	2.8
Mean Forecast	**1.4**	**1.8**	**2.2**	**2.5**	**2.7**
High	2.9	3.1	3.6	3.6	3.8
Low	0.9	1.0	1.1	1.0	1.5
Number of Observations	25	22	21	24	22
Government Target	**3.0±1.00**	**3.0±1.00**	**3.0±1.00**	**3.0±1.00**	**3.0±1.00**



*Probability distributions were averages of those provided by 20 out of 25 respondents.
(Source: BSP Survey)

Results of the BSP's survey of private sector economists for December 2015 yielded lower mean inflation forecasts for 2015-2017 relative to the results in September 2015.[5] In particular, the mean inflation forecast for 2015 was lower at 1.4 percent (from 1.7 percent in September 2015). Similarly, the average annual inflation forecasts for 2016 and 2017 declined to 2.5 percent and 2.7 percent (from 2.7 percent and 2.9 percent), respectively.

The analysts attributed their lower inflation expectations mainly to lower global oil prices and lower domestic utility rates. These are likely to outweigh the upside risks brought by the El Niño phenomenon, typhoons, increased expenditure from the upcoming election, robust consumer spending during the holiday season, weakening of the domestic currency, and possible adjustments in utility rates.

Based on the probability distribution on the forecasts provided by 20 out of 25 respondents, there is an 81.7-percent chance that average inflation for 2015 will settle within the 1.0-1.99 percent range, which is below the 2-4 percent target range for the year. Furthermore, respondents assigned a 5.8-percent chance that 2015 inflation rate will fall within the 2-4 percent target range in 2015. Meanwhile, for 2016, there is a 63.9-percent chance that inflation will fall within the 2-4 percent target band.

Similarly, results of the December 2015 Consensus Economics survey showed lower mean inflation forecast for 2015 and 2016 at 1.4 percent (from 1.9 percent in September 2015) and 2.5 percent (from 3.2 percent), respectively.[6]

[5] There were 25 respondents in the BSP's survey of private sector economists in December 2015. The survey was conducted between 10 December 2015 to 4 January 2016.
[6] There were 19 respondents in the Consensus Economics' survey in December 2015.

Q4 2015 BES results indicate that more respondents expect inflation to increase for the current and next quarter

Meanwhile, based on the BSP Business Expectations Survey (BES), a higher majority of respondents in Q4 2015 expect inflation to move up in the current quarter relative to the previous quarter (from a diffusion index of 10.2 percent to 18.2 percent). However, the number of respondents that expect inflation to increase in the next quarter decreased (from 26.4 percent to 21.4 percent).

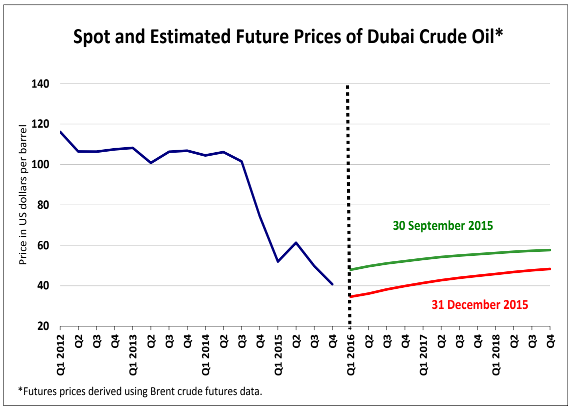
Consumers expect inflation to remain stable

In contrast, results of the Q4 2015 BSP Consumer Expectations Survey (CES) anticipate inflation to remain steady at 4.2 percent, indicating well-anchored inflation expectations.

Energy Prices

Global oil price drops further in Q4 2015 due to ample supply

The average price of Dubai crude oil dropped further in Q4 2015, declining by 18.2 percent quarter-on-quarter (q-o-q) as concerns of an oversupplied crude market intensified due largely to developments in the US and the Organization of Petroleum Exporting Countries (OPEC).



Crude stockpiles in the US have been consistently rising in 2015 and has reached 1,182.5 million barrels[7] for the week ending 25 December—this was higher by 9.9 percent compared to year-ago levels. In addition, recent proposed policies namely, the US government's decision to sell 8 percent of crude from its Strategic Petroleum Reserve (SPR) and the US Congress' support to remove the 40-year US oil export ban, could potentially exacerbate the global oil supply glut.

The continued decline in global oil prices can also be attributed to OPEC's recent decision to retain current production quotas during its last policy meeting on 4 December. Estimated OPEC crude oil production has continued to exceed its quota of 30 million barrels per day (mmbd) since June 2014.[8]

In Q4 2015, estimated futures prices of Dubai crude oil, which are based on movements in Brent crude oil futures, showed a lower path for 2016 to 2018 relative to the previous end-quarter.

[7] Includes the Strategic Petroleum Reserve (SPR)
[8] Source: Bloomberg

Oil demand estimates higher in 2015 but mixed results for 2016

All three international energy agencies adjusted oil demand projections upward in December 2015 relative to September estimates. The US Energy Information Administration (EIA),[9] International Energy Agency (IEA),[10] and OPEC[11] projected global oil demand for 2015 to increase by 1.4 mmbd (from 1.2 mmbd), 1.53 mmbd (from 1.46 mmbd), and 1.8 mmbd (from 1.70 mmbd), respectively.

For 2016, both the IEA and OPEC lowered demand projections. By contrast, the US EIA estimated oil demand to increase by 1.4 mmbd from 1.3 mmbd in the September 2015 report.

Rollbacks in domestic pump prices amidst low global oil prices

In Q4 2015, the domestic prices of gasoline, kerosene and diesel decreased by ₱2.35 per liter, ₱4.37 per liter, and ₱4.95 per liter, respectively, relative to their end-Q3 2015 levels. In marked contrast to domestic pump prices, LPG increased by ₱4.14 per liter during the quarter.

Meanwhile, comparing prices to year-ago levels, domestic pump prices of gasoline, kerosene, diesel, and LPG prices were significantly lower in Q4 2015.

DOMESTIC RETAIL PUMP PRICES (PESO/LITER) *
end-quarter prices

QUARTER	GASOLINE	KEROSENE	DIESEL	LPG
2014 Q1	53.75	50.87	44.25	41.73
Q2	54.95	51.51	43.70	40.27
Q3	52.15	47.99	40.70	38.74
Q4	41.20	37.39	30.05	33.87
2015 Q1	42.60	35.59	28.85	31.19
Q2	45.90	37.49	29.65	30.18
Q3	42.25	33.44	26.80	28.00
Q4	39.90	29.07	21.85	32.14
QUARTER-ON-QUARTER CHANGE				
2015 Q4	(2.35)	(4.37)	(4.95)	4.14
YEAR-ON-YEAR CHANGE				
2015 Q4	(1.30)	(8.32)	(8.20)	(1.73)

*Average Metro Manila retail pump prices for the big three oil companies: Caltex, Petron and Shell
Source: Department of Energy (DOE)

Power

Lower generation charges lead to decreased retail electricity prices

Overall electricity rates went down in Q4 2015 due to lower generation costs. For Q4 2015, the average generation charge decreased by ₱0.40 per kilowatt hour (kWh) to ₱4.07per kWh from ₱4.47 per kWh in Q3 2015. The decline in the average electricity rates during the quarter was driven generally by the lower generation cost from the Wholesale Electricity Spot Market (WESM) in October 2015, which offset the slight increases recorded in November and December 2015. The increases in the latter part of 2015 were attributed to increased outages of power plants, lower generation from hydro plants, and higher fuel costs due the weakening of the peso.

[9] US EIA, December 2015 Short-Term Energy Outlook, www.eia.gov
[10] IEA, December 2015 Oil Market Report, www.iea.org
[11] OPEC, December 2015 Monthly Oil Market Report, www.opec.org

There are potential sources of upside pressures on electricity charges. Meralco has existing petitions for rate increases with ERC which include the petition to implement the Maximum Average Price for 2012, 2013, 2014, and 2015, amended application for a rate increase in the January 2014 billing (consisting of incremental fuel costs and deferred generation cost to be collected monthly for six months); and petitions for the refund of generation over/under recovery (GOUR), transmission over/under recovery (TOUR), system loss over/under recovery (SLOUR), and lifeline subsidy over/under recovery (LSOUR) for the period January-December 2011. In addition, the Power Sector Assets and Liabilities Management's (PSALM) has several pending petitions with ERC for the recovery of True-Up Adjustments of Fuel and Purchased Power Costs (TAFPPC), Foreign Exchange Related Costs (TAFxA) and Purchased Power Costs and Foreign Exchange Related Costs by the National Power Corporation (NPC), and NPC's Stranded Debt portion of the universal charge. Likewise, the National Grid Corporation of the Philippines (NGCP) also filed several petitions to recover connection charges and residual sub-transmission charges for 2011-2013 and the costs of repair on damages caused by force majeure events such as earthquake, flooding, landslides, and lightning incidents in 2011-2012.

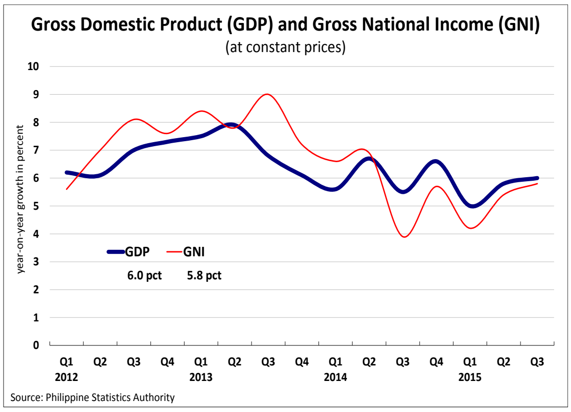
Water

MWSS implements rates adjustments for concessionaires due to FCDA

Effective 1 October 2015, the foreign currency differential adjustment (FCDA) for Q4 2015 charged by Manila Water Company, Inc. (MWCI) and Maynilad Water Services, Inc. (MWSI) increased by ₱0.03 per cubic meter and ₱0.11 per cubic meter, respectively. As a result, the all-in-water rates of MWCI and MWSI rose by ₱0.04/cu.m. (from ₱33.96/cu.m to ₱34.00/cu.m.) and ₱0.15/cu.m. (from ₱45.72/cu.m. to ₱45.87/cu.m.), respectively.

Aggregate Demand and Supply

The Philippine economy sustains momentum in Q3 2015



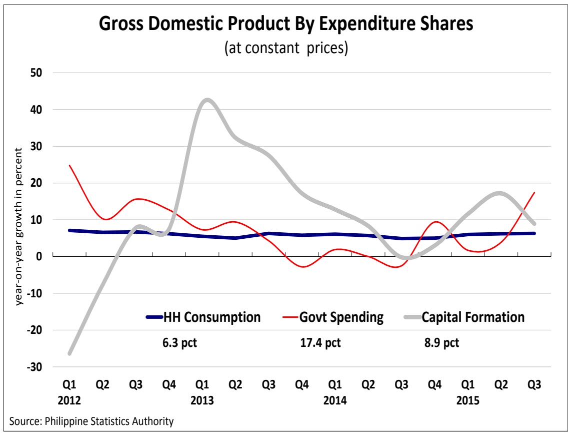
The Philippine economy grew by 6.0 percent in Q3 2015, higher than the 5.8 percent growth in the previous quarter and the 5.5 percent growth in the same period last year. The third quarter growth was driven by accelerated consumer and government spending and increasing fixed capital investments, particularly in durable equipment and public construction. Meanwhile, the services and industry sectors continued to be the main drivers of growth on the production side.

On a seasonally-adjusted basis, q-o-q, GDP growth decelerated to 1.1 percent in Q3 2015 from 2.0 percent in Q2 2015.

Gross national income (GNI) growth accelerated to 5.8 percent in Q3 2015 from the previous quarter's growth of 5.4 percent. Likewise, net primary income rose by 4.7 percent in Q3 2015 (from 3.6 percent in Q2 2015) which was driven mainly by the higher growth in compensation inflow (from 1.6 percent in Q2 2015 to 6.3 percent in Q3 2015).

Aggregate Demand

Household consumption find boost in benign inflation



Household spending, which accounted for more than half of the country's output at 68.5 percent, rose by 6.3 percent in Q3 2015, a slight acceleration from the 6.2 percent growth in the previous quarter. Lower inflation boosted household consumption during the quarter. The top contributors to growth of household final consumption expenditure were food and non-alcoholic beverages, miscellaneous goods and services and transport.

Growth in investments in capital formation slowed down to 8.9 percent in Q3 2015 from 17.2 percent in Q2 2015. The decline is due to lower accumulation in inventories during the review quarter and the slowdown in private construction. Meanwhile, fixed capital growth accelerated to 9.3 percent from 8.9 percent last quarter. The expansion can be attributed to the following: higher growth in private investments in

ECONOMIC PERFORMANCE at constant 2000 prices growth rate in percent				
BY EXPENDITURE ITEM	2014	2015		
	Q3	Q1	Q2	Q3
Household Consumption	4.9	6.0	6.2	6.3
Government Consumption	-2.5	1.7	3.9	17.4
Capital Formation	-0.2	11.6	17.2	8.9
Fixed Capital Formation	10.7	10.0	8.9	9.3
Exports	12.1	6.4	2.1	6.4
Imports	4.7	8.7	10.4	13.5

Source: Philippine Statistical Authority (PSA)

durable equipment as investments in road vehicles increased, along with car sales;[12] appreciable growth in public construction; positive growth in intellectual property products due to increased investments in computer software and databases; and accelerated growth in investments in breeding stock and orchard development due to increased production of livestock, poultry and orchards.

Meanwhile, government expenditures posted a double-digit growth of 17.4 percent in Q3 2015 (from 3.9 percent in Q2 2015) owing to increased disbursements of major government expenditures for salaries and wages as well as maintenance and other operating expenses (MOOE) for the implementation of projects and social protection programs.

External trade remained in deficit as growth in imports continued to outperform that of exports in Q3 2015. Nonetheless, overall exports growth picked up in Q3 to 6.4 percent from 2.1 percent a quarter-ago as exports of goods accelerated further due mainly to the increase in exports of semiconductors. This was offset partially by the deceleration in exports of services as growth of miscellaneous services, such as construction and financial services, slowed down. Meanwhile, overall imports posted a 13.5-percent growth in Q3, higher than the quarter-ago increase of 10.4 percent, owing to the double-digit growth in imports of goods. Growth in imports of semiconductors, albeit lower compared to that of the previous quarter, and the accelerated growth in machinery and mechanical appliances, contributed mainly to growth of imports of goods in Q3. Meanwhile, imports of services slowed down due largely to the contraction of imports in transportation and insurance and the lower growth in imports of miscellaneous services, such as financial services, charges for the use of intellectual property, and personal, cultural and recreational.

[12] Data based on the Chamber of Automotive Manufacturers of the Philippines (CAMPI) and Association of Vehicle Importers and Distributors (AVID).

Other Demand Indicators

Demand indicators continue to affirm strong domestic activity

Demand indicators continued to show positive signals during the review quarter. The property sector continues to grow at a manageable pace, vehicle sales sustains its double-digit growth while the composite Purchasing Managers' Index remains well above the 50-point expansion threshold in November, indicating continued firm domestic demand. Moreover, current- and next-quarter business confidence remained firm while consumer sentiment showed optimistic trends.

Property Prices

Land Values, Metro Manila

Implied land values trend higher but still below 1997 levels in real terms

Data from Colliers International indicated that implied land values[13] in the Makati CBD and Ortigas Center appreciated in Q3 2015 from quarter- and year-ago levels. Implied land values in the Makati CBD reached ₱463,500/sq.m. in Q3 2015, higher by 2.4 percent and 6.6 percent relative to the levels recorded in Q2 2015 and Q3 2014, respectively. Similarly, implied land values in the Ortigas Center rose by 4.5 percent q-o-q and 12.0 percent year-on-year to ₱172,500/sq.m.

Continued demand for office space keeps vacancy rates low

Land values in the Makati CBD were above their 1997 levels in nominal terms, but only about 47.7 percent of their 1997 levels in real terms. Meanwhile, land values in the Ortigas Center were about 88.5 percent of their 1997 level in nominal terms and 38.7 percent in real terms.

Vacancy Rates, Metro Manila

The office vacancy rate in the Makati CBD was slightly higher at 2.1 percent in Q3 2015 relative to quarter-ago and year-ago level of 1.9 percent. Nevertheless, it remains significantly below 2009 rates. The continued demand for office space in the Makati CBD, particularly for premium and Grade A buildings, has kept office vacancy rates low. However, Colliers anticipates office vacancy to rise to 4.4 percent in Q3 2016 as the completion of new office buildings from 2015 to 2017 would surpass projected demand.

[13] In the absence of reported closed transactions, implied land values based on trends are used by Colliers International to monitor prices.

Higher residential vacancy rates due to completion of new residential buildings

Similarly, the residential vacancy rate in the Makati CBD increased to 8.3 percent in Q3 2015 from 7.6 percent in the previous quarter. The residential vacancy rate in Q3 2015 was also higher than the year-ago level of 8.1 percent due to recent residential building completions. The delivery of new residential condominium units within the next 12 months is expected to increase vacancy rates further to 10.2 percent by Q3 2016.

Rental Values, Metro Manila[14]

Office rental values show slight increase

Monthly Grade A office[15] rents in the Makati CBD reached ₱905/sq.m. in Q3 2015, representing an increase of 1.2 percent from the previous quarter. Similarly, monthly Grade A office rents in the Makati CBD were higher by 7.7 percent relative to Q3 2014.

Office rental values for Grade A offices were above their 1997 levels in nominal terms. In real terms, office rental values were about half of the comparable levels in 1997.

Residential rental values rise slightly

Monthly rents for luxury three-bedroom condominium units in the Makati CBD rose to ₱875/sq.m. in Q3 2015 or a 1.6 percent growth from the previous quarter. Likewise, monthly rents for the 3-bedroom segment were higher by 5.4 percent compared to the year-ago levels.

Residential rental values for luxury three-bedroom high-rise units were above their 1997 levels in nominal terms but were only about 80.6 percent of their 1997 levels in real terms.

Capital Values, Metro Manila

Capital values for office and residential buildings are higher

Capital values[16] for office buildings in the Makati CBD in Q3 2015 were higher in nominal terms than their quarter- and year-ago levels. Grade A office capital values in the Makati CBD rose to ₱104,500/sq.m., higher by 1.0 percent and by 8.5 percent compared to the quarter- and year-ago levels, respectively.

[14] Actual rentals for housing account for 13.8 percent of the 2006-based CPI basket. The NSO presently surveys rentals only ranging from around ₱300-₱10,000/month to compute rent inflation. However, the rental values discussed in this section pertain to high-end rented properties, which may be considered as indicators of wealth and demand.
[15] Grade A refers to office space with capital values between ₱65,000 and ₱75,000/sq.m..
[16] Probable price that the property would have fetched if sold on the date of the valuation. The valuation includes imputed land and building value.

Grade A office capital values were also higher than the 1997 levels in nominal terms. Nevertheless, in real terms, office capital values were about 57.5 percent of the comparable levels in 1997.

Capital values for luxury residential buildings[17] in Makati CBD in Q3 2015 rose to ₱151,000/sq.m. from their quarter- and year-ago levels. Average prices for three-bedroom luxury residential condominium units increased by 1.3 percent q-o-q and 5.8 percent year-on-year.

Capital values for luxury residential buildings were above their 1997 levels in nominal terms. In real terms, residential capital values were about 67.8 percent of the comparable levels in 1997.

Vehicle Sales

Sales of new vehicles continue to grow robustly

Sales of new vehicles[18] grew by 27.3 percent y-o-y in the first two months of Q4 2015 from a 33.6-percent growth recorded in the same period a year ago. The Chamber of Automotive Manufacturers of the Philippines, Inc. (CAMPI) attributed the continued growth in car sales to the introduction of new car models, continuous marketing efforts and attractive financing programs of industry players.

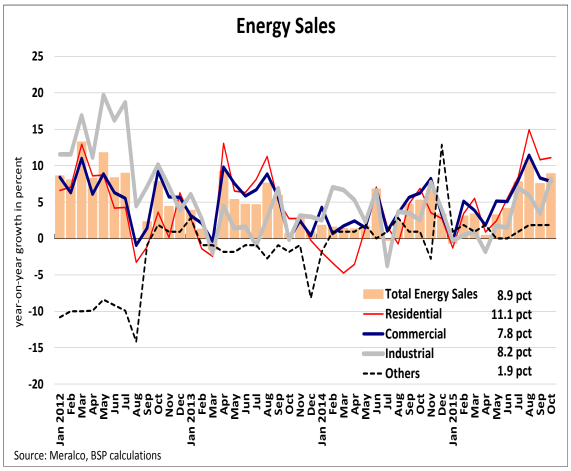
Passenger car sales from CAMPI members grew by 28.6 percent y-o-y in October-November 2015, accruing to a total of 21,884 units from 17,015 units sold in the same period in 2015. Similarly, commercial vehicles, which accounts for about 61 percent of total vehicle sales, expanded by 26.5 percent in the first two months of Q4 2015. Commercial vehicles sold during the quarter reached 33,762 units from 43,700 units in the same period in 2014.

[17] In terms of location, luxury residential units are located within the CBD core and have quality access to/from and have superior visibility from the main avenue. Meanwhile, in terms of general finish, luxury residential units have premium presentation and maintenance.

[18] Vehicle sales data is gathered on a monthly basis by the Chamber of Automotive Manufacturers of the Philippines (CAMPI). CAMPI represents the local assemblers and manufacturers of vehicle units in the Philippine automotive industry. The following are the active members of CAMPI: (1) Asian Carmakers Corp., (2) CATS Motors, Inc., (3) Columbian Autocar Corp., (4) Honda Cars Philippines, Inc., (5) Isuzu Philippines Corp., (6) Mitsubishi Motors Philippines Corp., (7) Nissan Motor Philippines Corp., (8) Suzuki Philippines Inc., (9) Toyota Motor Philippines Corp. and (10) Universal Motors Corp.

Energy Sales

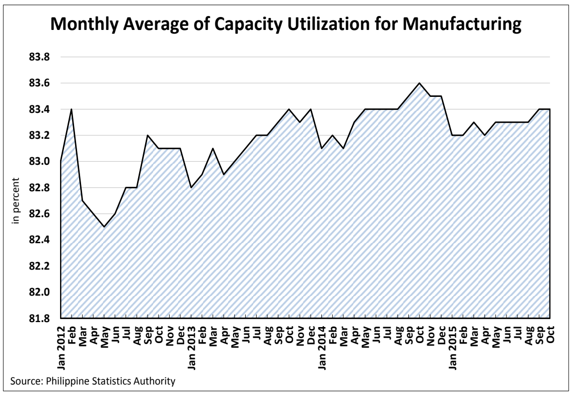
Energy sales increase in October



Total energy sales of Meralco increased by 8.9 percent y-o-y in October 2015, higher compared to the 5.2-percent growth a year ago. Residential Energy Sales (RSALES), Commercial Energy Sales (CSALES), and Industrial Sales (ISALES) rose by 11.1 percent, 7.8 percent and 8.2 percent to 965.8 kWh, 1,248.0 kWh and 963.8 kWh y-o-y, respectively, in October 2015. Meanwhile, as of October 2015, the year-to-date (y-t-d) growth rate of power sales is 4.9 percent.

Capacity Utilization

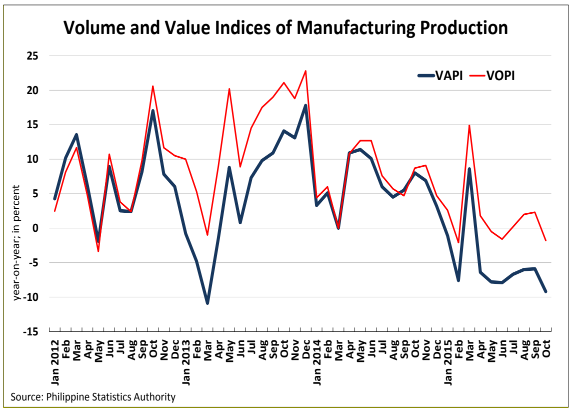
Capacity utilization in manufacturing remains above 80 percent



The average capacity utilization rate of the manufacturing sector was unchanged at 83.4 percent in October 2015 from the month-ago level based on the Philippine Statistics Authority's Monthly Integrated Survey of Selected Industries (MISSI). Of the 629 respondent-establishments, 60.3 percent of these operated at least at 80.0 percent capacity in October 2015. Data show that manufacturing companies have been operating above the 80.0 percent capacity since 2010.

Volume and Value of Production

Manufacturing output decline slightly



Preliminary results of the MISSI showed that volume of production index (VoPI) contracted in October 2015 by 1.8 percent year-on-year from a 2.3 percent (revised) growth in September 2015. This was led by the double-digit reductions in the production of petroleum products (-20.3 percent), beverages (-19.7 percent), food manufactures (-15.7 percent), and wood and wood products (-14.0 percent).

The cutback in factory output—as measured by the VoPI—is attributed to the weakening demand from China and other parts of the globe, coupled with the ill effects of El Niño on business activities, the National Economic and Development Authority (NEDA) said in a press statement dated 10 December 2015. For instance, the petroleum subsector reduced output as supply from the US and Organization of Petroleum Exporting Countries remains ample, while global demand for oil is low. Likewise, output of the food subsector declined amid the lingering El Niño weather conditions and due to the adverse effects of typhoons *Egay*, *Ineng*, and *Lando* on production.

Similarly, the value of production index (VaPI) dipped further in October 2015 by 9.2 percent, from a contraction of 5.9 percent (revised) in the previous month. The VaPI has been in the negative territory since January 2015 except in March 2015. The drop in VaPI was led by double-digit declines in the following sub-sectors: petroleum products (-35.2 percent), furniture and fixtures (-30.5 percent), wood and wood products (-29.4 percent), food manufactures (-15.6 percent), and beverages (-13.2 percent).

Business Expectations

Business sentiment at record high in Q4 2015…

BUSINESS EXPECTATIONS SURVEY

BUSINESS OUTLOOK INDEX	2014		2015			
	Q3	Q4	Q1	Q2	Q3	Q4
Current Quarter	34.4	48.3	45.2	49.2	41.4	51.3
Next Quarter	52.9	43.1	58.2	47.3	53.1	43.9

Source: Bangko Sentral ng Pilipinas (BSP)

Business outlook on the economy turned more upbeat for Q4 2015[19], with the overall confidence index (CI) rising to 51.3 percent from 41.4 percent for Q3 2015. This CI—the highest in two years—indicates that more businesses are optimistic about the country's economic prospects for the last quarter of the year. Respondents cited the following factors for their more optimistic outlook: (a) expected increase in consumer demand during the Christmas, main palay harvest and milling seasons; (b) sustained increase in sales, orders and projects leading to higher volume of production; (c) expansion of businesses and new product lines; (d) introduction of new and enhanced business strategies and processes; (e) steady flow of overseas Filipinos' (OFs) remittances, especially during the holiday season; and (f) election-related spending in the run-up to the 2016 national elections. Their more positive outlook was further driven by expectations of brisker business due to the Philippines' hosting of the Asia-Pacific Economic Cooperation (APEC)

[19] The Q4 2015 BES was conducted during the period 1 October - 16 November 2015 among 1,514 firms nationwide. Respondents were drawn from the combined list of the Securities and Exchange Commission's Top 7,000 Corporations in 2010 and Business World's Top 1000 Corporations in 2013, consisting of 606 companies in NCR and 908 firms in AONCR, covering all 17 regions nationwide. The survey response rate for this quarter was higher at 83.6 percent (from 81.9 percent in the previous quarter). The response rates were higher both for NCR at 81.5 percent (from 80.4 percent in the previous quarter) and for AONCR at 85 percent (from 83 percent in Q3 2015).

Leadership Summit, higher disbursements for the government's infrastructure and other development projects, and the favorable macroeconomic conditions in the country, particularly manageable inflation, low interest rates, and a stable peso. The sentiment of businesses in the Philippines mirrored the buoyant business outlook in Australia, Japan and the Euro Area, but was in contrast to the weaker sentiment of businesses in the US, UK, China, Hong Kong, Germany, Russia, Indonesia, Singapore and India.

...but turns less sanguine in the next quarter

For the next quarter (Q1 2016), business outlook turned less optimistic, with the CI at 43.9 percent from 53.1 percent in the last quarter's survey. The next quarter CI suggests that the optimists continued to outnumber the pessimists but the number of respondents with favorable views declined relative to the previous quarter's survey results. Respondents attributed their less sanguine outlook for Q1 2016 to the typical slowdown in demand after the holiday season. Other reasons cited by firms were stiffer competition, concerns over the adverse effects of El Niño, and uncertainties in the global economy.

Consumer Expectations

Consumer confidence improves in Q4 2015...

CONSUMER EXPECTATIONS SURVEY

CONSUMER OUTLOOK INDEX	2014		2015			
	Q3	Q4	Q1	Q2	Q3	Q4
Current Quarter	-26.3	-21.8	-10.0	-16.2	-11.6	-8.1
Next 3 Months	-1.0	0.7	4.4	-0.4	5.8	5.7
Next 12 Months	9.7	9.6	17.3	16.4	15.8	18.0

Source: Bangko Sentral ng Pilipinas (BSP)

Consumers' outlook improved for Q4 2015[20] as the overall confidence index (CI) rose to -8.1 percent from -11.6 percent for Q3 2015. The higher (but still negative) CI for Q4 2015 means that the number of households with an optimistic view increased but was less than those who think otherwise.

According to respondents, their more favorable outlook during the current quarter was due to expectations of: (a) more jobs and increase in the number of working family members; (b) additional income/higher salary due to receipt of Christmas bonus and 13th month pay; (c) stable prices of commodities; (d) effective government policies; (e) improvements in

[20] The Q4 2015 CES was conducted during the period 1-12 October 2015 covering 6,020 households, of which 2,904 (48.2 percent) were from NCR and 3,116 (51.8 percent) from AONCR. Of the sample size, 5,845 households responded to the survey, equivalent to a response rate of 97.1 percent (from 97.6 percent in the last quarter's survey). The respondents consist of 2,838 households (with 97.7 percent response rate) in NCR and 3,007 households (with 96.5 percent response rate) in AONCR. Nearly half of the respondents (47.3 percent) were from the low-income group, 38.7 percent from the middle-income group, and 14 percent from the high-income group.

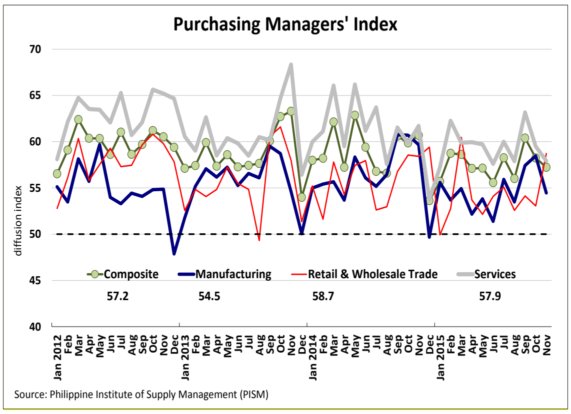
infrastructure; and (f) brisker business activity leading to higher household income. The outlook of consumers in the Philippines mirrored the improved sentiment of consumers in Australia, Canada, Euro Area, Indonesia, Japan, South Korea, and Thailand but was in contrast to the less optimistic views of those in China, Taiwan, United Kingdom and the United States for Q4 2015.

...and sustains optimism for Q1 2016

For the next quarter (Q1 2016), consumers' optimism was sustained as the CI was broadly steady at 5.7 percent compared to the previous quarter's survey results. This indicates that the optimists continued to top the pessimists for the next quarter. Consumers' sentiment was more favorable for the next 12 months, with the CI increasing to 18 percent from 15.8 percent a quarter ago. Consumers anticipated lower unemployment, improvements in the country's economy and the election of new government officials for the year ahead.

Purchasing Managers' Index[21]

PMI remains firmly above the 50-point expansion threshold



The composite PMI remained firmly above the 50-point expansion threshold[22] at 57.2 in November 2015. However, this was lower than the previous month's composite PMI at 58.2. The decline was attributed mainly to the slowdown in the rate of expansion of the manufacturing and services sectors. These sectors accounted for 84 percent of the weighted composite index. By contrast, the retail and wholesale sector moved at a faster pace in November 2015.

The manufacturing PMI in November 2015 decelerated by 4 ppts to 54.5 from 58.5 in October 2015. Capacity build-up in September and October adequately matched the expected demand during the holiday season, thus expansion in November moved at a slower pace. Manufacturing companies reported that weaker demand, lower overall production, reduced level of stockpiles, and lower number of new hires

[21] Data based on the monthly purchasing managers' index report of the Philippine Institute for Supply Management.
[22] The actual formula used to calculate the PMI assigns weights to each common element and then multiplies them by 1.0 for improvement, 0.5 for no change, and 0 for deterioration. As a result, an index above 50 indicates economic expansion, and an index below 50 implies a contraction. PMI surveys are conducted on the last week of the month.

contributed to the slower expansion of the sector. The New Orders index also showed slower expansion as a result of the weaker demand in November. Eight of the twelve manufacturing subsectors grew at a slower pace compared to the month-ago levels namely, food and beverages, paper manufactures, non-metallic minerals, basic metals, fabricated metal, machinery, communication and medical equipment, and motor vehicles.

The services PMI slightly slowed down as the index decreased to 57.9 in November 2015 from 59.5 in October 2015, which is consistent with the market's expectation. Slower expansions were noted in five of the six indices during the month due to weaker business activity, lower number of new services contracted, fewer task orders in progress, lower price charges on services rendered, and lower average operating cost. Nonetheless, all the sub-indices remained well above the 50-point expansion threshold.

Meanwhile, the retail and wholesale PMI rebounded in November as it reached 58.7 from 53.1 in October. All the sub-indices were higher led by the double-digit increment of the purchases sub-index. Consequently, the supplier deliveries index increased to accommodate the additional purchases in November. The retail subsector PMI increased by 6.3 index points to 61.5 in November from 55.2 in October. Likewise, the wholesale subsector PMI rose by 5.6 index points to 52.4 from 46.8 in the same review period.

External Demand

Exports

Export performance remains negative on lower external demand

EXPORTS OF GOODS
growth rate in percent

COMMODITY GROUP	2014	2015	
	Q3	Q2	Q3
Coconut Products	38.0	-19.5	-29.7
Sugar and Products	-20.6	-69.9	-89.9
Fruits and Vegetables	0.4	-45.5	-27.3
Other Agro-Based Products	17.3	-15.1	-22.3
Forest Products	-14.9	-17.6	-57.2
Mineral Products	3.9	-41.9	-43.7
Petroleum Products	-50.0	-14.8	1.0
Manufactures	14.5	15.7	-3.8
Special Transactions	-5.9	-45.4	130.7
Total Exports	12.6	-8.3	-8.1

Source: BSP staff computations based on data from the Philippine Statistical Authority (PSA)

Export of goods continue to contract in Q3 2015, falling by 8.1 percent y-o-y. The decline in exports is attributed to lower demand from the country's Asian trading partners[23] which account for the bulk of the country's exports. Foreign shipments across all export commodities decreased except for petroleum products which grew by 1.0 percent.

Imports

Imports of goods turn positive

IMPORTS OF GOODS
growth rate in percent

COMMODITY GROUP	2014	2015	
	Q3	Q2	Q3
Capital Goods	0.1	17.4	21.5
Raw Materials and Intermediate Goods	-7.5	2.2	34.1
Mineral Fuels and Lubricants	15.3	-36.2	-51.9
Consumer Goods	20.4	12.3	34.1
Special Transactions	-6.7	28.2	26.9
Total Imports	2.5	-1.6	11.6

Source: BSP staff computations based on data from the Philippine Statistical Authority (PSA)

Imports of goods grew by 11.6 percent in Q3 2015, a turnaround from the 1.6-percent decline in the previous quarter and higher than the 2.5-percent growth posted in the same period in 2014. The growth in imports was due to the double-digit expansion in inward shipments of capital goods, raw materials and intermediate goods, and consumer goods, offsetting the contraction in the import bill of mineral fuels and lubricants.

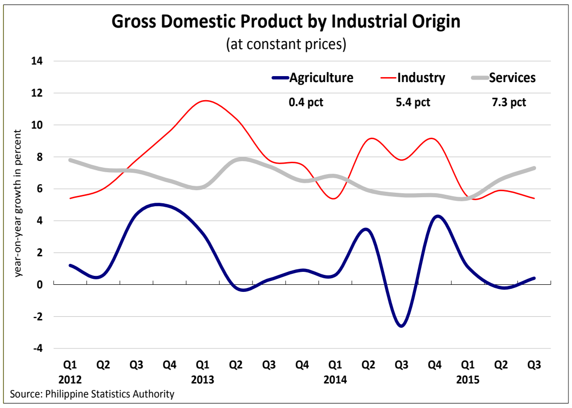
Aggregate Supply

Services sector remains the main driver of output growth on the production side

The services sector expanded by 7.3 percent in Q3 2015, higher than the 6.6-percent growth in the previous quarter. Major contributors to the sector's growth were as follows: trade and repair of motor vehicles, motorcycles, personal and household goods; real estate, renting and business activities; and other services. The increase in output of trade and repair of motor vehicles, motorcycles, personal and household goods sector can be attributed mainly to the strong growth of retail trade. Similarly, real estate, renting and business activities picked up largely on account of the higher growth of renting

[23] East Asia (includes China, Hong Kong, Japan, Macau, Mongolia, North Korea, South Korea and Taiwan) and ASEAN (includes Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, Singapore, Thailand and Vietnam)

and other business activities. Meanwhile, the growth in other services was due primarily to the accelerated increase of hotels and restaurants services.



Meanwhile, the industry sector slowed down marginally to 5.4 percent in Q3 2015 from 5.9 percent in Q2 2015. This was due mainly to the slowdown in construction activities, offsetting the improvement in manufacturing. The deceleration in construction was largely on account of the sluggish performance of private construction. Meanwhile, growth in manufacturing came mainly from radio, television and communication equipment and apparatus, and chemical and chemical products.

ECONOMIC PERFORMANCE
at constant 2000 prices
growth rate in percent

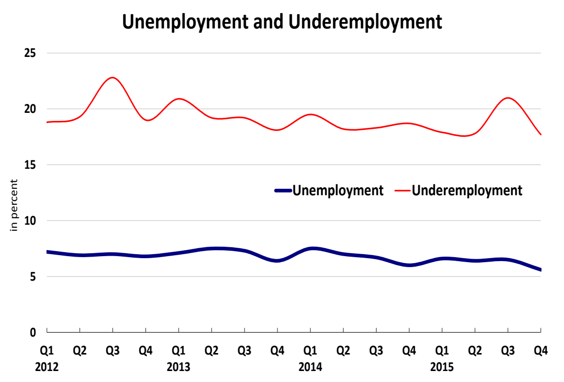
BY INDUSTRIAL ORIGIN	2014	2015		
	Q3	Q1	Q2	Q3
Agri., Hunting, Forestry and Fishing	-2.6	1.1	-0.2	0.4
Agriculture and Forestry	-2.6	1.9	-0.3	0.0
Fishing	-2.4	-2.9	-0.1	1.7
Industry Sector	7.8	5.5	5.9	5.4
Mining and Quarrying	4.2	-3.1	-7.1	0.9
Manufacturing	7.5	6.0	4.7	5.6
Construction	13.1	5.4	15.3	4.8
Electricity, Gas and Water Supply	3.0	5.1	2.7	6.7
Service Sector	5.6	5.4	6.6	7.3
Transport, Storage and Communication	5.2	8.3	6.4	7.6
Trade and Repair of Motor Vehicles, Motorcycles, Personal and Household Goods	7.0	5.5	6.6	7.9
Financial Intermediation	8.4	4.3	5.8	6.0
Real Estate, Renting and Business Activities	6.7	6.3	7.0	7.7
Public Administration and Defense; Compulsory Social Security	-2.9	-3.5	-0.3	3.1
Other Services	3.9	6.6	10.0	8.0

Source: Philippine Statistical Authority (PSA)

Finally, the Agriculture, hunting, forestry and fishery (AHFF) sector rebounded to 0.4 percent in Q3 2015 from a contraction of 0.2 percent in Q2 2015. The positive turnaround of the sector was attributed mainly to the improved growth of poultry, particularly chicken and chicken eggs, and agricultural activities and services.

Labor Market Conditions

Unemployment rate improves notably



Source: Philippine Statistics Authority

Based on the Labor Force Survey (LFS) as of October 2015, the Philippine labor market showed notable performance as it posted the lowest unemployment rate since 2005 while most of the employment indicators improved relative to the same period in 2014. The country's unemployment rate went below 6.0 percent for the first time at 5.7 percent,[24] which is equivalent to a decline in unemployment level by 137,000 to 2.3 million. This lower unemployment rate relative to 6.0 percent in October 2014 was due to the 0.4-percent growth in employment which outpaced the 0.1-percent growth in labor force.

The growth in employment in October 2015 resulted from the 2.1 percent and 2.8 percent growth in employment in services and industry sectors, respectively, which offset the 3.7 percent decline in agriculture sector.

Employment in services sector was driven by wholesale and retail trade (2.5 percent), public administration and defense (7.5 percent), and administrative and support service activities (8.3 percent)[25] while employment in industry sector benefited from strong employment growth in construction (5.6 percent), particularly public-led infrastructure development, and manufacturing (1.1 percent) sub-sectors.

The decline in employment in agriculture was due to the adverse effects of weather disturbances on the sector,[26] particularly the drought caused by El Niño on agriculture production and the rainy season on fishing activities.

Unemployment rate among the youth (15-24 years old) also declined in October 2015 to 13.6 percent from 14.2 percent in the same period last year as the contraction in the level of youth unemployment (8.0 percent) was larger than the decrease in youth labor force (3.7 percent).[27]

[24] Including Leyte, the resulting unemployment rate in October 2015 is 5.6 percent.
[25] This includes the business process outsourcing sector.
[26] NEDA (2015), "Unemployment rate drops to new record low in 10 years," 10 December. http://www.neda.gov.ph/2015/12/10/unemployment-rate-drops-to-new-record-low-in-10-years/.
[27] The youth comprises less than half of the unemployed in October 2015. According to NEDA (2015), some youth decided not to look for work possibly because they chose to pursue higher education or undergo training, as indicated

Similarly, the underemployment rate went down to 17.6 percent from 18.7 percent in October 2014 and this was due to contractions in both visible[28] (-7.9 percent) and invisible[29] (-2.6 percent) underemployment.

The higher share of full-time employment to total employment (65.2 percent from 63.7 percent a year ago) accompanied by the lower share of part-time employment to total employment (34.2 percent from 35.4 percent a year ago)[30] also resulted in an increase in the country's overall mean hours of work to 41.6 from 41.2, which could indicate a higher level of economic activities in the fourth quarter of 2015.

The average unemployment rate in the four labor force surveys conducted in 2015[31] was estimated at 6.3 percent, lower than the 6.6-6.8 percent unemployment target that was set by the government for 2015 as indicated in the Philippine Development Plan Midterm Update. However, in terms of underemployment rate, the estimated 18.5 percent average is still higher than the 18.0 percent target for the year, indicating that the country still needs to implement more measures to improve the quality of employment in the country.

by the increase in tertiary education enrolment rate, as well as the increase in technical vocational engagements. The drop in the level of unemployed youth could be attributed to the government's efforts to help young jobseekers through job fairs, provision of access to technical and life skills training demanded by employers, and mentoring to improve job searches and outcomes.

[28] This refers to underemployed part-time workers or those who work less than 40 hours per week.

[29] This refers to underemployed full-time workers or those who work 40 hours or more per week.

[30] NEDA (2015). The remaining share to total employment refers to employees who did not work (0.7 percent from 0.9 percent in October 2014).

[31] This is the unofficial annual figure, estimated only by getting the average of January, April, July, and October LFS data (excluding Leyte).

II. MONETARY AND FINANCIAL MARKET CONDITIONS

Domestic Liquidity and Credit Conditions

Domestic liquidity remains ample

Money supply or M3 grew by 9.2 percent y-o-y in November 2015 from 8.7 percent in end-Q3 2015 due mainly to robust demand for credit. Domestic claims rose by 11.6 percent in November, slower than the 12.7-percent increase at end-Q3 2015 on sustained bank lending growth. Meanwhile, net public sector credit grew by 10.5 percent in November from 16.5 percent at the end of the previous quarter.

The growth in net foreign assets (NFA) was faster at 9.0 percent y-o-y in November from 6.8 percent in end-Q3 2015. The BSP's NFA position continued to expand during the month on the back of robust foreign exchange inflows coming mainly from overseas Filipinos' remittances and business process outsourcing receipts. The NFA of banks likewise increased as banks' foreign assets expanded at a faster pace relative to that of their foreign liabilities. Banks' foreign assets rose due mainly to the growth in their investments in marketable debt securities, while banks' foreign liabilities grew on account of higher deposits and placements made by foreign banks with other banks.

...while bank lending sustains growth

As of November 2015, outstanding loans of commercial banks, net of banks' reverse repurchase (RRP) placements with the BSP, grew by 13.6 percent y-o-y relative to the 12.6 percent and 19.9 percent growth posted at end-Q3 2015 and end-Q4 2014, respectively.

The sustained expansion of bank lending was driven largely by loans for production activities, which expanded by 14.1 percent y-o-y in November 2015. The expansion in production loans was due to the increased lending to the following sectors: real estate activities; manufacturing; electricity, gas, steam and airconditioning supply; wholesale and retail trade, and repair of motor vehicles and motorcycles; financial and insurance activities; and, construction. Meanwhile, loans for household consumption grew by 13.3 percent as of November 2015, higher than the 12.7 percent growth registered in end-Q3 2015 but lower than the 21.1 percent expansion in end-Q4 2014.

Credit Standards

Results of the Q4 2015 Senior Bank Loan Officers' Survey (SLOS)[32] showed that most of the respondent banks maintained their credit standards for loans to both enterprises and households during the quarter based on the modal approach.[33] This is the 27th consecutive quarter since Q2 2009 that the majority of banks reported broadly unchanged credit standards.

Meanwhile, the diffusion index (DI) approach[34,35] pointed to a slight net easing of overall credit standards for loans to both enterprises and households in Q4 2015 as respondent banks reporting more accommodative credit standards outnumbered those reporting tighter credit standards. In the previous quarter, credit standards for corporate lending were unchanged while those for household loans eased slightly based on the DI approach.

Lending to Enterprises

Most respondent banks maintain credit standards for loans to enterprises

Most banks (90.3 percent of banks that responded to the question) indicated that credit standards for loans to enterprises remained steady during the quarter using the modal approach. Meanwhile, a slight net easing was observed using the DI approach. The slight net easing of credit standards reflected respondent banks' increased tolerance for risk as well as their improved outlook on certain industries. In terms of specific credit standards, respondent

[32] The survey consists of questions on loan officers' perceptions relating to the overall credit standards of universal/commercial banks (U/KBs) in the Philippines, as well as to factors affecting the supply of and demand for loans by both enterprises and households. Survey questionnaires were sent to all commercial banks, except for one bank that requested not to be included in the survey since it does not engage in corporate and retail lending. Thirty-four banks responded to the current survey representing a response rate of 97.1 percent. As of end-September 2015, U/KB loans accounted for about 86.9 percent of the banking system's total outstanding loans.
[33] In the modal approach, the results of the survey are analyzed by looking at the option with the highest share of responses.
[34] In the diffusion index approach, a positive diffusion index (DI) for credit standards indicates that the proportion of banks that have tightened their credit standards are greater compared to those that eased ("net tightening"), whereas a negative DI for credit standards indicates that more banks have eased their credit standards compared to those that tightened ("net easing").
[35] From Q1 2010 to Q4 2012 survey rounds, the BSP used largely the DI approach in the analysis of survey results. Beginning in Q1 2013, the BSP used both the modal and DI approaches in assessing the results of the survey.

banks reported narrower loan margins, increased credit line sizes, and longer loan maturities.[36]

GENERAL CREDIT STANDARDS FOR LOANS TO ENTERPRISES (OVERALL)

	2014		2015			
	Q3	Q4	Q1	Q2	Q3	Q4
Tightened Considerably	0.0	0.0	3.4	0.0	0.0	3.2
Tightened Somewhat	3.2	3.2	13.8	3.2	6.3	0.0
Remained Basically Unchanged	**93.5**	**93.5**	**79.3**	**93.5**	**87.5**	**90.3**
Eased Somewhat	3.2	3.2	3.4	3.2	6.3	6.5
Eased Considerably	0.0	0.0	0.0	0.0	0.0	0.0
Total	100.0	100.0	100.0	100.0	100.0	100.0
Diffusion Index for Credit Standards	0.0	0.0	13.8	0.0	0.0	-3.2
Weighted Diffusion Index for Credit Standards	0.0	0.0	8.6	0.0	0.0	0.0
Mean	3.0	3.0	2.8	3.0	3.0	3.0
Number of Banks Responding	31	31	29	31	32	31

Note: A positive diffusion index for credit standards indicates that more banks have tightened their credit standards compared to those that eased ("net tightening"), whereas a negative diffusion index for credit standards indicates that more banks have eased their credit standards compared to those that tightened ("net easing").

In terms of borrower firm size, overall credit standards eased across all firm sizes, except for micro enterprises based on the DI approach. Meanwhile, credit standards for micro enterprises were unchanged.

For the next quarter, results based on both modal and DI approaches show expectations of overall unchanged credit standards, particularly for large middle-market enterprises and small and medium-sized enterprises. Respondent banks cited their stable economic outlook and unchanged tolerance for risk as among the key reasons behind the expected unchanged credit standards.

Lending to Households

Most respondent banks report unchanged credit standards for loans to households

The survey results likewise showed that most of the respondent banks (81.8 percent) continued to report unchanged overall credit standards for loans extended to households. However, the DI approach showed a slight net easing of credit standards for household loans in Q4 2015. Respondent banks attributed the easing of credit standards largely to banks' increased tolerance for risk and improved profile of borrowers. In particular, banks' responses indicated overall increased credit line sizes and less strict loan covenants for loans extended to households.

GENERAL CREDIT STANDARDS FOR LOANS TO HOUSEHOLDS (OVERALL)

	2014		2015			
	Q3	Q4	Q1	Q2	Q3	Q4
Tightened Considerably	4.8	0.0	0.0	0.0	0.0	0.0
Tightened Somewhat	9.5	14.3	10.5	9.5	4.2	4.5
Remained Basically Unchanged	**81.0**	**85.7**	**84.2**	**81.0**	**87.5**	**81.8**
Eased Somewhat	4.8	0.0	5.3	9.5	8.3	13.6
Eased Considerably	0.0	0.0	0.0	0.0	0.0	0.0
Total	100.0	100.0	100.0	100.0	100.0	100.0
Diffusion Index for Credit Standards	9.5	14.3	5.3	0.0	-4.2	-9.1
Weighted Diffusion Index for Credit Standards	7.1	7.1	2.6	0.0	-2.1	-4.5
Mean	2.9	2.9	2.9	3.0	3.0	3.1
Number of Banks Responding	21	21	19	21	24	22

Note: A positive diffusion index for credit standards indicates that more banks have tightened their credit standards compared to those that eased ("net tightening"), whereas a negative diffusion index for credit standards indicates that more banks have eased their credit standards compared to those that tightened ("net easing").

Most of the respondent banks foresee maintaining their overall credit standards over the next quarter. However, some banks expect overall credit standards to ease slightly, particularly for housing and auto loans, due largely to expectations of banks' increased tolerance for risk and less strict financial system regulations.

[36] The survey questionnaire asks banks to describe changes in six specific credit standards: (1) loan margins (price-based); (2) collateral requirements; (3) loan covenants; (4) size of credit lines; (5) length of loan maturities; and (6) interest rate floors. A loan covenant is an agreement or stipulation laid down in loan contracts, particularly contracts with enterprises, under which the borrower pledges either to take certain action (an affirmative covenant), or to refrain from taking certain action (a negative covenant); this is consequently part of the terms and conditions of the loan. Meanwhile, an interest rate floor refers to a minimum interest rate for loans. Greater use of interest rate floor implies tightening while less use indicates otherwise.

Loan demand

Loan demand from both enterprises and households is unchanged

Responses to the survey question on loan demand indicated that the majority of the respondent banks continued to see unchanged overall demand for loans from both enterprises and households. Using the DI approach, however, results showed a net increase in overall loan demand[37] from both enterprises and households. The net increase in loan demand of firms was attributed by banks to increased accounts receivable financing needs of borrower firms and clients' improved economic outlook. Meanwhile, the net increase in overall demand for household loans reflected higher household consumption and banks' more attractive financing terms.

Looking ahead, most of the respondent banks expect unchanged loan demand from both firms and households. However, a larger proportion of respondents expect overall demand for corporate loans to increase further in the next quarter relative to those who indicated the opposite. Improved economic outlook of clients along with expectations of higher working capital and accounts receivable financing needs of borrower firms were cited by respondent banks as key factors behind the anticipated increase in demand for business loans. Meanwhile, the expected net increase in household loan demand was attributed by respondent banks to more attractive financing terms, higher household consumption, and lower interest rates.

Real Estate Loans

Credit standards for real estate loans remain steady

Overall credit standards for commercial real estate loans were unchanged in Q4 2015 based on both the modal and DI approaches as all of the respondent banks (100.0 percent) indicated basically unchanged overall credit standards for the said type of loan. The unchanged overall credit standards for commercial real estate loans reflected respondent banks' stable economic outlook and unchanged tolerance for risk as well as unchanged profile of borrowers, among

[37] The "DI for loan demand" refers to the percentage difference between banks reporting an increase in loan demand and banks reporting a decrease. A positive DI for loan demand indicates that more banks reported an increase in loan demand compared to those stating the opposite, whereas a negative DI for loan demand implies that more banks reported a decrease in loan demand compared to those reporting an increase.

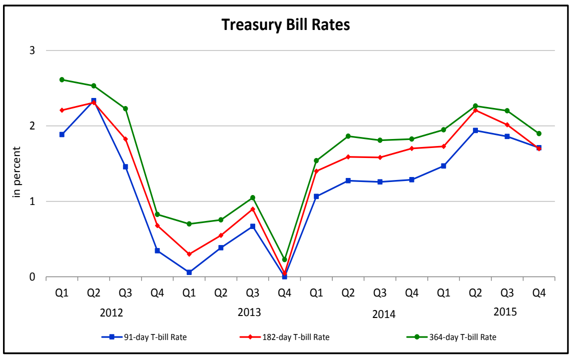
others. In terms of specific credit standards for commercial real estate loans, banks' responses showed unchanged loan covenants but with wider loan margins, stricter collateral requirements, and increased use of interest rate floors. For the next quarter, most of the respondent banks expect to maintain their credit standards for commercial real estate loans. However, based on the DI approach, a slight net tightening of overall credit standards for commercial real estate loans is seen.

Demand for commercial real estate loans was also unchanged in Q4 2015 based on the modal approach. A number of banks, however, indicated increased demand for the said type of loan on the back of clients' improved economic outlook and increased customer inventory financing needs, among others. Over the next quarter, although most of the respondent banks anticipate generally steady loan demand, a number of banks expect demand for commercial real estate loans to increase further.

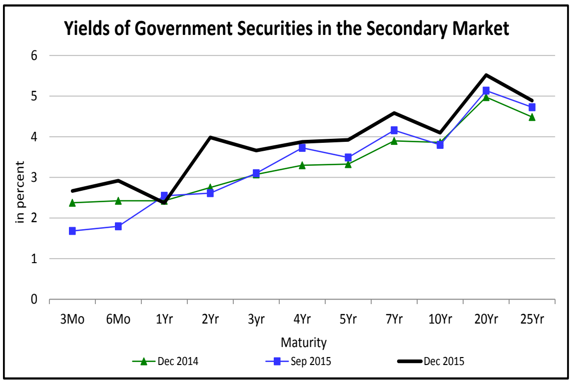
Similarly, in the case of housing loans extended to households, most of the respondent banks (76.5 percent) reported unchanged credit standards. Using the DI approach, however, a slight easing of credit standards for housing loans was noted in Q4 2015. The net easing of credit standards for housing loans was attributed by respondent banks to their increased tolerance for risk and the improvement in the overall profile of borrowers. For the next quarter, although most respondent banks foresee maintaining their credit standards for housing loans, a number of banks expect a slight easing of credit standards for this type of loan largely on expectations of higher tolerance for risk. At the same time, results continued to show increased demand for housing loans in Q4 2015 as well as expectations of a continued increase in demand for the said type of loan in the next quarter.

Interest Rates

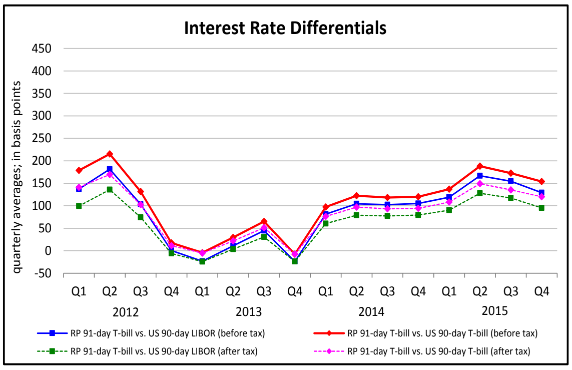
T-bill rates in the primary market decline



The yield curve rises



Interest rate differentials narrow further



Primary Interest Rates

In Q4 2015, the average 91-day, 182-day, and 364-day T-bill rates in the primary market decreased to 1.710 percent, 1.697 percent, and 1.897 percent from 1.861 percent, 2.014 percent, and 2.200 percent, respectively, in Q3 2015. The decrease in T-bill rates reflected the market players' preference for lower-tenored papers amid global uncertainties.

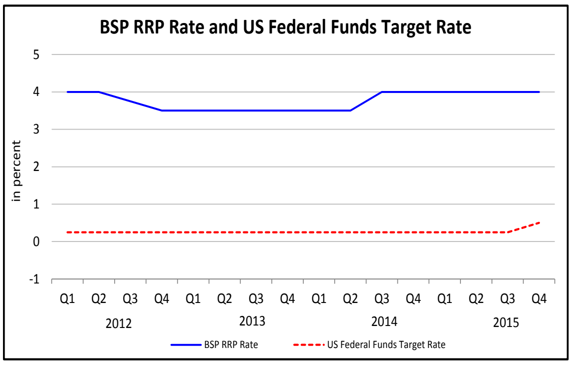
Yield Curve

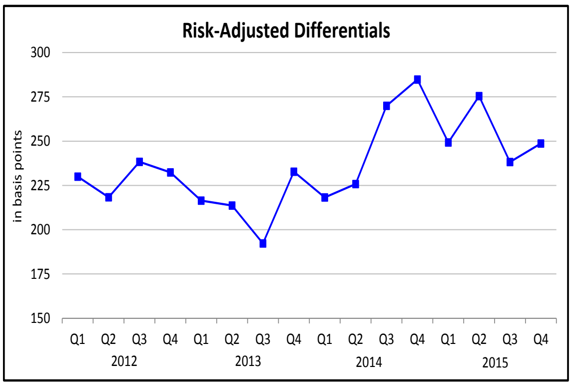
The secondary market yield of government securities (GS) rose generally, except for the 1-year GS, as of end-December 2015 relative to the end-September 2015 levels, following the US Federal (Fed) funds target rate hike in December 2015. Debt paper yields were higher by a range of 14.9 bps (4-year GS) to 137.0 bps (2-year GS) compared to end-September 2015 levels. By contrast, the interest rate for the 1-year GS declined by 17.6 bps.

Relative to year-ago levels, the secondary market yields of GS increased generally by a range of 23.7 bps for the 10-year GS to 123.5 bps for the 2-year GS except for the 1-year which declined by 5.4 bps.

Interest Rate Differentials

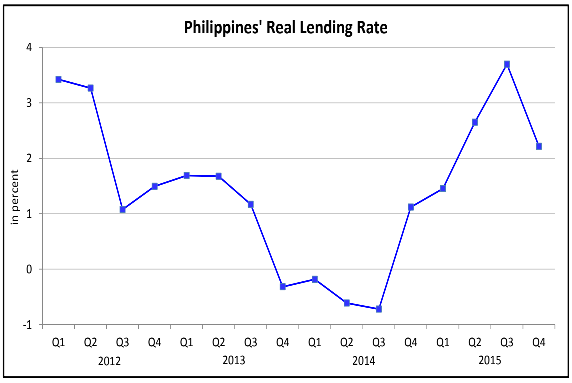
The average differentials between domestic and US interest rates, gross and net of tax, narrowed further in Q4 2015 relative to the previous quarter. The average 91-day RP T-bill rate declined q-o-q by 16.1 bps to 1.700 percent in Q4 2015 from 1.861 percent in Q3 2015. Meanwhile, the average US 90-day LIBOR and US 90-day T-bill rate increased by 9.5 bps and 2.6 bps, respectively, to 0.409 percent and 0.161 percent in Q4 2015. Foreign interest rates rose on investor optimism following the interest rate hike by the US Fed and the release of better-than-expected US economic data during the quarter.





The positive differential between the BSP's overnight borrowing or RRP rate and the US Fed funds target rate narrowed to a range of 350-375 bps in Q4 2015 from 375-400 bps in Q3 2015, reflecting the impact of the 25-bp increase in the US Fed funds target rate to 0.25-0.50 percent on 17 December 2015. Meanwhile, the interest rate differential between the BSP's overnight RRP rate and the US Fed funds target rate adjusted for country risk premium[38] widened to 249 bps as of end-December 2015 from 238 bps in end-September 2015. This development could be traced to the lower risk premium combined with the decrease in the positive interest rate differential between the BSP's RRP rate and the US Fed funds target rate. The decline in the risk premium could be attributed to the increase in the 10-year US note, relative to the decrease in the 10-year ROP yield, to 2.26 percent and 3.28 percent, respectively. The 10-year US note rose following the release of stronger-than-expected US data on labor and employment, fixed business investments, housing, and household spending during the review quarter.

Real lending rate decreases



The real lending rate[39] declined to 2.2 percent in December 2015 from 3.7 percent in September 2015. This was due to the 90-bp rise in inflation to 1.5 percent in December 2015 from 0.4 percent in September 2015 and the 40-bp decline in the actual bank lending rate[40] to 3.7 percent. The Philippines posted the fourth lowest real lending rate in a sample of 10 Asian countries, with Indonesia recording the highest real lending rate at 8.8 percent and Japan the lowest at 0.8 percent.

[38] The difference between the 10-year ROP note and the 10-year US Treasury note is used as proxy for the risk premium.
[39] Real lending rate is measured as the difference between actual bank lending rate and inflation.
[40] The actual bank lending rate for the Philippines is the weighted average interest rate charged by reporting commercial banks on loans and discounts granted during the period.

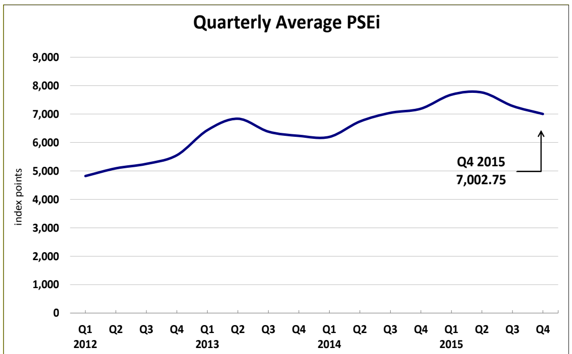
Financial Market Conditions

Domestic financial market conditions reflect external uncertainties

The domestic financial system remained stable, supported by strong macroeconomic fundamentals during the review quarter. However, external headwinds emanating from the continued economic weakness in China and the uncertainties related to the US interest rate lift-off have contributed toward the uptick in investor risk perception and a flight to safe-haven assets. Nonetheless, the performance of the domestic financial market remained favorable compared to other countries in the region.

Stock Market

External headwinds see the benchmark index dip in Q3



Source: Philippine Stock Exchange, BSP

The Philippine Stock Exchange index (PSEi) averaged 7,002.75 index points in Q4 2015, about 3.9 percent lower than the average registered in the preceding quarter. Growing concerns about the outlook for global growth amid continued weakness in China and expectations of the US Fed raising interest rates for the first time in almost ten years in December, combined with mixed domestic corporate earnings reported for Q3, dampened sentiments and fueled outflow of foreign investments during the review quarter. The PSEi closed the year at 6,952.08 index points on 29 December 2015, lower by 3.9 percent on a y-t-d basis, ending the local bourse's six-year winning streak.

Other stock market indicators reflect investors' bearish sentiments

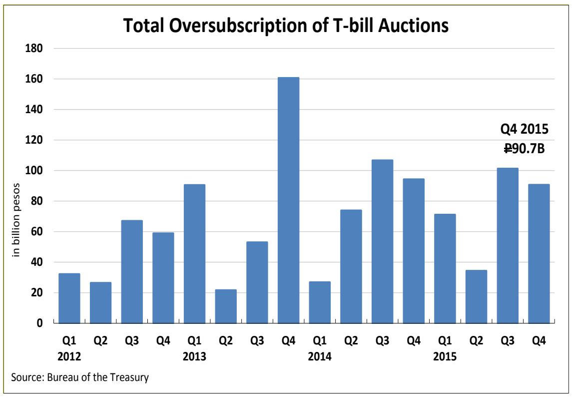
Stocks rallied in October following the US Fed's delay in hiking interest rates following the release of weak US labor and economic data. China's decision to cut rates anew on 23 October for the sixth time since November 2014, combined with prospects of additional stimulus from Europe and Japan, also boosted investors' appetite for risks. The PSEi closed at 7,289.26 index point on 28 October, higher than the end-September level by 5.7 percent.

In November, however, local shares consolidated anew on concerns over China's continued weakness. The terrorist attacks in Paris on 13 November further extended the losing streak in the local bourse. On 16 November, the PSEi closed to its lowest in 17 months at 6,772.92 index points. The decline was tempered partly by expectations that the US Fed's rate increase will likely be gradual as well as the release of favorable Q3 domestic growth data. The PSEi closed at 6,927.07 index points on 27 November, lower by 2.9 percent than the level posted in end-October.

The local bourse continued to consolidate in December over hawkish comments made by the US Fed Chairman that signaled a December rate hike, a disappointing stimulus plan by the European Central Bank (ECB) and reports of mixed domestic corporate earnings in Q3 2015. The market's bearish bias continued following OPEC's decision to abandon the group's 30 million barrels-per-day production limit to retain market share and combat the threat from the US shale industry. Meanwhile, China's introduction of a new trade-weighted yuan exchange rate index on 11 December renewed fears of a currency war. Subsequently, the PSEi posted another low on 15 December of 6,701.35 index points, the lowest level registered since June 2014. On 17 December, however, the local bourse posted strong gains as the well-telegraphed move of the US Fed to raise interest rates from historic lows on 16 December ended the long period of uncertainty in the global markets. Year-end window dressing further boosted the index to close at 6,952.08 index points on 29 December, higher by 0.4 percent relative to the end-November level but still lower by 3.9 percent (y-t-d).

Total market capitalization also retreated in Q4 2015 from ₱13.3 trillion in October to ₱13.6 trillion as of 23 December 2015. This reflected the continued withdrawal of foreign investors, posting net sale of ₱15.2 billion in Q4 for a total foreign net sale of ₱59.7 billion for 2015. Moreover, data from Bloomberg indicated that the price-earnings ratio of listed shares continued its decline in 2015, with the Philippine P/E ratio dipping from an average of 20.6x in Q3 to 20.1x in Q4. Philippine shares remained the second most expensive in the ASEAN5, next to Indonesia's 26.7x registered in the last three months of the year.

Government Securities

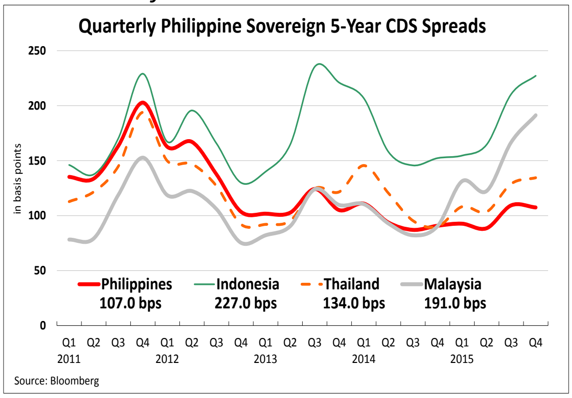


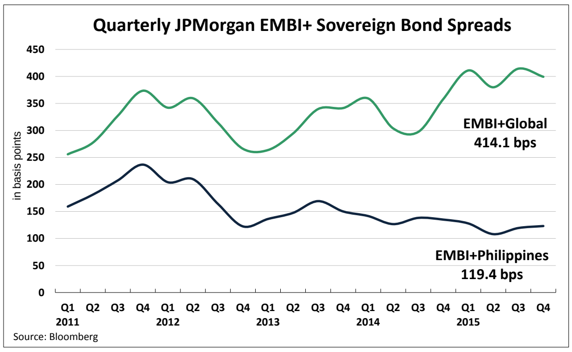
Results of the T-bill auctions conducted in Q4 2015 continued to show strong demand for government securities with total subscription for the quarter amounting to ₱90.7 billion, about 1.5 times higher than the ₱60.0 billion total offered amount. The oversubscription for the quarter at ₱30.7 billion was lower than the ₱101.3 billion oversubscription in the previous quarter.

The Bureau of the Treasury (BTr) decided to partially award bids for all tenors in auctions held during the review quarter. However, in the 5-October auction, the Auction Committee awarded in full the total offering for the 182-day and 362-day T-bills. Meanwhile, in the 2-November auction, the BTr decided to reject all bids for the 364-day T-bills. The results of the Q4 auctions reflected the government's healthy cash position as well as market players' concern over the US Fed rate hike before the end of the year.

Sovereign Bond and CDS Spreads

Debt spreads widen due to uncertainties on the external front





The cost of insuring Philippine sovereign debt decreased in Q4 2015. The country's 5-year sovereign credit default swap (CDS) spreads averaged 107 basis points (bps) during the review quarter, down from the average of 109 bps in the previous quarter. Against those of neighboring economies, the Philippine CDS traded lower than Indonesia's average of 227 bps, Malaysia's 191 bps and Thailand's 134 bps. However, the risk premium for holding a Philippine sovereign bond over a similarly tenured US Treasury bond climbed as indicated by the wider EMBIG Philippine spreads which averaged 123 bps in Q4, higher than the previous quarter's 117 bps.

Debt spreads in October eased slightly amid stable global economic and financial environment. US economic activity expanded at a moderate pace and household spending and business fixed investment increased as well. Meanwhile, the Euro area showed signs of slow recovery. These positive developments outweighed the fear of investors coming from a weakening Chinese economy as the latter cut interest rates during the month.

In November, debt spreads continued to ease as investors traded on a conservative stance as they wait for the US Fed interest rate hike. The statement by Federal Open Market Committee (FOMC) during the month assured market participants that the holdings of long-term securities will be maintained at sizable levels to keep accommodative financial conditions given the uncertainty in the timing and magnitude of the US Fed normalization.

Finally, on 16 December 2015, the US Fed decided to increase the Fed funds rates to 0.25-0.50 percent, ending the almost a decade of zero interest rate regime. The US Fed cited job growth as the key reason for raising the interest rates and the return of unemployment rate to pre-crisis level of 5 percent, as well as the declining trend in jobless claims. Investors welcomed the rate hike, bidding up prices of US Treasury bonds which pushed yields down in advance economies. Meanwhile, in emerging Asia, bond yields had a muted reaction since investors already factored the Fed hike prior to the decision.

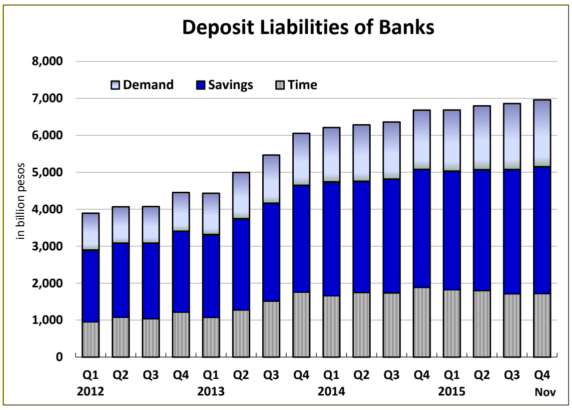
By 31 December, the Philippine's 5-year sovereign CDS stood at 109 bps, lower than the 134 bps recorded in end-Q3 and has remained lower than Indonesia's 233 bps, Malaysia's 182 bps and Thailand's 140 bps. The EMBIG Philippines also ended narrower at 124 bps in Q4 compared to the previous quarter's closing of 145 bps.

Banking System

Philippine banking system remains robust

The Philippine banking system maintains its strong position as it continues to support economic growth. Banks' balance sheets were marked by a sustained growth in assets and deposits. Asset quality indicators also continued to improve, while capital adequacy ratios remained above international standards, even with the implementation of the tighter Basel III framework.

Savings Mobilization



Savings and time deposits remained the primary sources of funds for the banking system. Banks' total deposits[41] as of end-November 2015 amounted to ₽7.0 trillion, 8.5 percent or ₽0.5 trillion higher than the year-ago level. The growth in deposits recorded in end-November 2015 was higher than the 8.3-percent growth posted in the previous month. Savings and demand deposits expanded by 10.4 percent and 15.0 percent, respectively.[42] Time deposits, however, declined marginally by 1.0 percent or by ₽17.0 billion during the review period. Meanwhile, foreign currency deposits (FCD-Residents) owned by residents, grew by 12.7 percent, y-o-y, to ₽1.5 trillion.[43]

Institutional Developments

The total resources of the banking system grew by 10.5 percent to ₽11.9 trillion as of end-September 2015 from the year-ago level of ₽10.7 trillion. As share to GDP, total resources stood at 90.5 percent.

Total resources of the banking system continue to rise

The number of banking institutions (head offices) fell to 635 as of end-September 2015 from the year- and quarter- ago levels of 652 and 638, respectively, indicating continued consolidation of banks as well as the exit of weaker players in the banking system. By banking classification, banks (head offices) consisted of 37 universal and commercial banks (U/KBs), 69 thrift banks (TBs), and 529 rural banks (RBs). Meanwhile, the operating network (head offices and branches/agencies) of the banking system expanded to 10,606 offices in Q3 2015 from 10,207 offices during the same period in the previous year and 10,528 offices in Q2 2015, due mainly to the increase in the branches/agencies of U/KBs, TBs and RBs.

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[41] This refers to the total peso-denominated deposits of the banking system.
[42] The domestic liquidity or M3 growth in March 2015 also reflects statistical base effects associated with the significant increase in domestic liquidity a year ago of 35.3 percent, following the operational adjustments involving access of trust entities to the BSP SDA facility, which were completed in November 2013. Along with the savings, time and demand deposits, M3 includes currency in circulation and deposit substitutes.
[43] M4 is the sum of M3 and FCD-Residents. Along with savings, time and demand deposits, M3 includes currency in circulation and deposit substitutes.

Asset quality of Philippine banks continues to improve

The Philippine banking system's gross non-performing loan (GNPL) ratio at 2.3 percent, as of end-September 2015, was an improvement relative to the 2.6 percent and 2.4 percent posted a year- and a quarter- ago, respectively.[44] Banks' initiatives to improve their asset quality along with prudent lending regulations helped maintain the GNPL ratio below its pre-Asian crisis level of 3.5 percent.[45] Compared with the previous quarter, the Q3 2015 GNPL ratio reflected the GNPL increase of ₱1.7 billion, from ₱138.3 billion in Q2 2015 to ₱140.0 billion in Q3 2015, being outpaced by the banking system's TLP expansion of ₱164.4 billion, from ₱5.9 trillion in Q2 2015 to ₱6.0 trillion. The net non-performing loan (NNPL) ratio, on the other hand, remained unchanged at 0.6 percent relative to the ratios posted a year- and a quarter-ago. In computing for the NNPLs, specific allowances for credit losses[46] on TLP are deducted from the GNPLs. The said allowances decreased to ₱101.2 billion in end-September 2015 from the ₱102.3 billion posted a quarter ago.

The Philippine banking system's GNPL ratio of 2.3 percent was higher relative to Indonesia (2.1 percent), South Korea (1.5 percent) and Malaysia (1.2 percent), but lower when compared with Thailand (2.8 percent).[47]

The loan exposures of banks remained adequately covered as the banking system registered an NPL coverage ratio of 117.2 percent. The Q3 2015 coverage ratio was similar to the ratio registered a year-ago but lower than the 119.5 percent posted in end-June 2015. The ratio is indicative of banks' continued compliance with the loan-loss provisioning requirements of the BSP to ensure adequate buffers against potential credit losses.

[44] For comparative purposes, computations for periods prior to January 2013 are aligned with Circular No. 772. Certain ratios were rounded-off to the nearest hundredths to show marginal movements.
[45] The 3.5 percent NPL ratio was based on the pre-2013 definition.
[46] This type of provisioning applies to loan accounts classified under loans especially mentioned (LEM), substandard-secured loans, substandard-unsecured loans, doubtful accounts and loans considered as loss accounts.
[47] Sources: Various central bank websites, IMF and financial stability reports, Indonesia (commercial banks, Q4 2014); Malaysia (banking system [impaired loans/net loans], Q3 2015); Thailand (commercial banks, Q3 2015); and South Korea (domestic banks, Q3 2015).

Banks remain well-capitalized amidst tighter capital requirements

Compliance with the BSP capital framework for U/KBs under the Basel III framework[48] took effect in 1 January 2014. The new Basel III regime incorporates adjustments to the treatment of bank capital in ways that enhance the use of the CAR as a prudential measure.

U/KBs posted capital adequacy ratios (CARs) of 15.5 percent and 16.4 percent on solo and consolidated bases at end-June 2015. The end-June ratios were higher than the 15.1 percent and 16.1 percent CAR on solo and consolidated bases recorded a quarter earlier. The latest CAR figures were also above the 15.5 percent and 16.4 percent ratios registered in end-March 2014, which was the maiden reporting period for U/KBs under the Basel III framework. This is an indication that the banks have adjusted to the impact of Basel III capital reforms.

The industry's capital at end-June 2015 was composed mainly of Common Equity Tier 1 (CET 1), which refers to the highest quality among instruments eligible as bank capital. The CET 1 of U/KBs represented 12.9 percent and 13.9 percent of risk weighted assets (RWAs) on solo and consolidated bases at end-Q2. Tier 1 ratios also rose to 13.1 percent and 14.1 percent on solo and consolidated bases during said period. Tier 1 is composed of common equity and qualified capital instruments.

The increase in CAR was on account of the banks' capital raising activities and earnings generated in the Q2 2015 which enabled the industry to raise its qualifying capital by 6 percent q-o-q to ₱973.6 billion in June 2015.

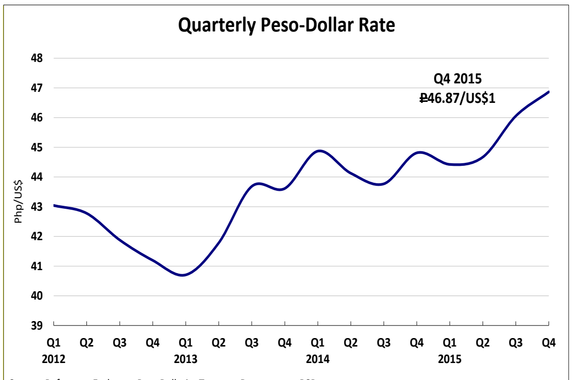
The CAR of U/KBs on a consolidated basis at 16.4 percent was higher than those of Malaysia (14.8 percent) and South Korea (14.0 percent), but lower compared to those of Indonesia (18.7 percent) and Thailand (17.3 percent).[49]

[48] Basel III no longer counts towards "bank capital" those Basel II-compliant capital instruments that do not have the feature of loss absorbency. Loss absorbency refers to the ability of bank-eligible capital instruments other than common equity to behave and act in the same way as common equity shares at the point where the bank takes losses and becomes non-viable. In addition, Basel III now deducts from capital the investments of banks in non-allied undertakings, defined benefit pension fund assets, goodwill and other intangible assets.

[49] Sources: Various central bank websites, IMF and financial stability reports, Indonesia (commercial banks, Q4 2014); Thailand (commercial banks, Q3 2015); Malaysia (banking system, Q3 2015); and Korea (domestic banks, Q3 2015).

Exchange Rate

Peso weakens on uncertainties related to the US interest rate hike



Source: Reference Exchange Rate Bulletin, Treasury Department, BSP.

The peso depreciated against the US dollar in the Q4 2015. On a q-o-q basis, the peso weakened by 1.7 percent to average ₱46.87/US$1 from the previous quarter's average of ₱46.05/US$1. On a y-o-y basis, the peso depreciated by 4.4 percent relative to the ₱44.81/US$1 average in Q4 2014.[50] The weakness of the peso was due to the uncertainty in the external environment arising mainly from the market's anticipation of a US Fed funds rate lift-off towards the end of 2015.

In October 2015, the peso strengthened to average ₱46.36/US$1 relative to the ₱46.75/US$1 average in September on continued risk-on sentiment amid rising expectations that the US Fed would raise interest rates in 2016 instead of December 2015. In November, the trend reversed as the peso depreciated at an average of ₱47.01/US$1 due mainly to safe-haven trade towards the US dollar as data showing an improvement in the US labor market further supported the case for a US Fed funds rate hike by year-end.[51] The weak inflation data in China and lackluster exports data in the Philippines likewise boosted the demand for the US dollar.[52,53] The peso weakened further in December to average ₱47.23/US$1 as the string of positive data in the US and the Fed's decision to increase policy rates boosted demand for the US dollar.[54,55] Nonetheless, the sustained inflows of foreign exchange from overseas Filipino remittances, foreign portfolio and direct investments, as well as the ample level of the country's gross international reserves provided support to the peso.[56]

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[50] Dollar rates or the reciprocal of the peso-dollar rates were used to compute for the percentage change.

[51] US jobless claims was unchanged at 276,000 in the week ended November 7, compared to market expectations of 270,000 but still near the 15-year low. Yet, claims have been below 300,000 since March, the level associated with a healthy jobs market. (Source: US Department of Labor)

[52] China's October consumer price index (CPI) eased more than expected, rising 1.3 percent from a year ago and compared with 1.6 percent in September (lower also than expectations of a 1.5 percent rise). (Source: China National Bureau of Statistics)

[53] Philippine exports suffered their worst decline in four years in September (preliminary), dropping 24.7 percent year-on-year to $4.41 billion, its worst turnout since September 2011's 27 percent plunge. (Source: Philippine Statistics Authority)

[54] The University of Michigan's consumer sentiment increased to 91.8 in December from 91.3 in November of 2015.

[55] US retail sales—excluding automobiles, gasoline, building materials and food services—increased 0.4 percent in November 2015 after a downwardly revised 0.1 percent gain in October. (Source: US Census Bureau)

[56] GIR stood at US$80.2 billion as of end-November 2015 (revised).

YEAR-TO-DATE CHANGES IN SELECTED DOLLAR RATES Appreciation/(-Depreciation), in percent				
	2012	**2013**	**2014**	**2015***
Chinese Yuan	1.00	2.60	-2.70	-4.30
Philippine Peso	6.80	-7.00	-0.70	-5.00
Singaporean Dollar	6.10	-2.70	-4.50	-6.00
Thai Baht (Onshore)	3.00	-4.60	-0.70	-8.90
New Taiwan Dollar	4.30	-1.90	-6.20	-3.60
Malaysian Ringgit	3.50	-5.50	-6.30	-18.60
Korean Won	7.70	1.10	-4.30	-6.60
Japanese Yen	-10.90	-16.30	-12.50	-0.50
Indonesian Rupiah	-5.90	-19.10	-2.10	-9.80
Indian Rupee	-3.10	-11.40	-2.90	-4.90

Notes:
- Negative value represents depreciation of the currency against the US dollar
- YTD changes are computed as the percent change between the closing prices for the year indicated versus the closing prices for the preceding year (i.e., closing prices are based on Bloomberg data as of 31 December except for the Philippine peso which used closing price for the last trading day of the year).
*Based on Bloomberg data as of 4:00 p.m., 29 December 2015

On a year-to-date basis, the peso depreciated against the US dollar by 5.0 percent on 29 December 2015 as it closed at ₱47.06/US$1, moving in tandem with most Asian currencies.[57]

[57] Based on the last done deal transaction in the afternoon.

III. FISCAL DEVELOPMENTS

NG posts higher deficit as of end-October 2015

NATIONAL GOVERNMENT FISCAL PERFORMANCE in billion pesos			
	2014	**2015**	**Growth Rate**
	Jan-Oct	**Jan-Oct**	(in percent)
Surplus	-33.6	-52.6	56.0
Revenues	1,577.3	1,768.0	12.0
Expenditures	1,610.9	1,820.6	13.0

* Totals may not add up due to rounding
Source: Bureau of the Treasury (BTr)

The fiscal deficit for January-October 2015 reached ₱52.6 billion, higher than the ₱33.6 billion deficit incurred during the same period in 2014. Meanwhile, netting out the interest payments in expenditures, the primary surplus amounted to ₱219.3 billion, 9.0 percent lower than the level recorded in the previous year.

Revenue collections rose by 12.0 percent to ₱1,768.0 billion as of end-October compared to ₱1,577.3 billion in the same period in 2014, due mainly to higher collections by other offices. Income from other offices rose by 93.0 percent to ₱179.2 billion. The Bureau of the Treasury and Bureau of Internal Revenue contributed ₱97.4 billion and ₱1,190.6 billion, which represented an increase of 13.0 percent and 8.0 percent, respectively, compared to their levels a year ago. Meanwhile, revenues from the Bureau of Customs remained steady with 0.3 percent growth to ₱300.7 billion.

Expenditures in the first ten months of 2015 reached ₱1,820.6 billion, 13.0 percent higher than what was recorded in the same period in 2014. Excluding interest payments, expenditures went up by 16.0 percent to ₱1,548.7 billion. Meanwhile, interest payment was 2.3 billion lower compared to its year-ago level, amounting to ₱271.9 billion as of end-October 2015.

IV. EXTERNAL DEVELOPMENTS

Global growth eases as the downturn in emerging markets continues

The JP Morgan Global All-Industry Output Index declined to 52.9 in December from 53.6 in November as the increase in new orders moderated. Downturns were noted in major emerging markets such as Brazil, China, and Russia. Meanwhile, output expansion held firm in many advanced economies, including the US, Japan, and UK. Faster growth was recorded in the euro area and in India.[58]

Growth in the US economy holds firm

Real GDP increased by 2.0 percent on a seasonally adjusted q-o-q in Q3 2015 after expanding by 3.9 percent in the previous quarter. On a y-o-y basis, real output growth was slightly slower at 2.1 percent in Q3 2015 compared to 2.7 percent in Q2 2015. The slower expansion during the quarter reflected a downturn in private inventory investment and a deceleration in exports, personal consumption expenditures, nonresidential fixed investment, and state and local government spending.[59]

Meanwhile, the manufacturing PMI dropped to 48.2 in December from 48.6 in the previous month, indicating a contraction in production for the second consecutive month.[60] A decline in new domestic orders accounted partly for the softness in manufacturing activity during the month.

Inflation on a y-o-y basis rose to 0.5 percent in November from 0.2 percent in October, as the indices for shelter, medical care, airline fares, new vehicles, and tobacco increased while the indices for food and energy decreased. Meanwhile, unemployment was unchanged at 5.0 percent in November from the same rate in October. Total nonfarm payroll employment increased by 211,000 during the month, with gains noted in construction, professional and technical services, and health care.

Measures of consumer confidence indicate an optimistic outlook by households on account of a more positive assessment of employment prospects and general economic conditions. The Conference

[58] JP Morgan Global Manufacturing & Services PMI, http://www.markiteconomics.com/
[59] US Bureau of Economic Analysis, "National Income and Product Accounts Gross Domestic Product: Third Quarter 2015 (Third Estimate)," news release, 22 December 2015. http://www.bea.gov/newsreleases/national/gdp/2015/gdp3q15_3rd.htm
[60] Institute for Supply Management, "December Manufacturing ISM *Report On Business*", 4 January 2016, https://www.instituteforsupplymanagement.org

Board Consumer Confidence Index rose to 96.5 in December from 92.6 in November,[61] while the Thomson-Reuters/University of Michigan Index of Consumer Sentiment increased to 92.6 in December from 91.3 in the previous month.[62]

Economic activity in the euro area strengthens

On a q-o-q basis, real GDP grew by 0.3 percent in Q3 2015, slightly slower than the 0.4-percent expansion in the previous quarter. On a y-o-y basis, real GDP growth was solid at 1.6 percent in both Q3 2015 and Q2 2015.[63] Meanwhile, the composite PMI for the euro area rose to 54.3 in December from 54.2 in November, as output expanded in both the manufacturing and service sectors on account of a robust increase in new incoming orders. Economic activity was solid in Ireland, Italy, Germany, and Spain.[64]

The seasonally adjusted unemployment rate declined to 10.7 percent in October from 10.8 percent in the previous month.[65] Meanwhile, inflation was stable at 0.2 percent in both November and December.[66]

The European Commission's Economic Sentiment Indicator for the euro area rose further to 106.8 in December from 106.1 in November, as confidence in industry improved. Meanwhile, consumer confidence was broadly unchanged.[67]

Manufacturing activity in Japan picks up

On a q-o-q basis, real GDP increased by 0.3 percent in Q3 2015 after declining by 0.1 percent in the previous quarter. Moreover, real GDP expanded by 1.6 percent y-o-y in Q3 2015 following the 0.7-percent increase in Q2 2015.[68] The improvement reflects the continued pick up in manufacturing activity. The seasonally adjusted manufacturing PMI was steady at 52.6 in December from the same level in November, as production continued to expand at a solid clip amid a faster increase in new domestic and export orders.[69]

[61] "The Conference Board Consumer Confidence Index improves in December." 29 December 2015. http://www.conference-board.org/
[62] "Discounts for all mean happy holidays." 23 December 2015. http://press.sca.isr.umich.edu/press/press_release
[63] Eurostat news release 214/2015 dated 8 December 2015.
[64] Markit Eurozone Composite PMI – final data, http://www.markiteconomics.com/
[65] Eurostat news release 210/2015 dated 1 December 2015.
[66] Eurostat news release 1/2016 dated 5 January 2016.
[67] European Commission. http://ec.europa.eu/
[68] Department of National Accounts, Economic and Social Research Institute, Cabinet Office. http://www.esri.cao.go.jp/
[69] Nikkei Japan Manufacturing PMI, http://www.markiteconomics.com/

Inflation remained at 0.3 percent in November from the same pace in October, while the seasonally adjusted unemployment rate increased to 3.3 percent in November from 3.1 percent a month earlier.

Indicators continue to point to subdued Chinese economic activity

Real GDP grew by 6.9 percent y-o-y in Q3 2015, the same pace as in the previous quarter. Agricultural and industrial production showed steady growth, while investment in fixed assets slowed down. The seasonally adjusted manufacturing PMI remained below the neutral 50.0 mark at 48.2 in December from 48.6 in November, indicating a continued contraction in manufacturing output as new domestic and export orders declined modestly.[70]

Inflation rose to 1.5 percent in November from 1.3 percent in October. The prices of food, particularly pork and fresh vegetables, drove inflation.

Services drive growth in India

Real GDP increased by 7.4 percent y-o-y in Q3 2015, faster than the 7.0-percent expansion in the previous quarter, with manufacturing and services posting faster growths during the quarter compared to the same period a year ago.[71] Meanwhile, the composite PMI increased to 51.6 in December from 50.2 in November, reflecting a strong expansion in services.

Inflation based on the consumer price index (CPI) increased to 5.4 percent in November from 5.0 percent in October.

A number of central banks ease their monetary policy settings to support domestic economic activity and stave off deflationary pressures, while the US Fed decides to raise interest rates

In October, the People's Bank of China (PBOC) cut its benchmark lending rate for the fifth time in 2015 to shore up domestic demand and counterbalance deflationary pressures. The PBOC also reduced its reserve requirement ratio for the fourth time during the year to provide support to the agricultural sector as well as to small and medium enterprises.

In December, the European Central Bank brought the interest rate on its deposit facility further down into negative territory to -0.3 percent but retained the interest rates for both the refinancing operations and the marginal lending facility. The decision was undertaken to help steer inflation towards the announced target of 2.0 percent and in

[70] Caixin China General Manufacturing PMI, http://www.markiteconomics.com/
[71] Central Statistics Office of India. http://mospi.nic.in/Mospi_New/Site/home.aspx

turn, anchor medium-term inflation expectations. The Reserve Bank of New Zealand likewise reduced its official cash rate given the need to direct inflation towards the announced inflation target of 1.0 – 3.0 percent.

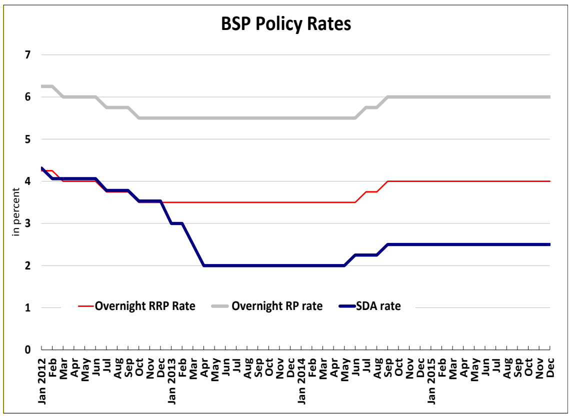
Meanwhile, the Central Bank of the Republic of China (Taiwan) decided to lower its discount rate to further stimulate the domestic economy given weak exports and projections of slower output growth. The Bank of Japan retained its 80 trillion yen growth target for the monetary base on 18 December but also introduced additional measures for quantitative and qualitative monetary easing partly to steer investments towards increasing physical and human capital and to smoothen the implementation of its quantitative easing program.

Bank Indonesia lowered its primary reserve requirements to increase financing capacity in support of domestic economy.

The US Fed decided to raise the federal funds rate by 25 bps to 0.25-0.50 percent, effective 16 December 2015. Inflation forecasts suggest an increasing path towards the 2-percent target. At the same time, labor market conditions continue to improve, with unemployment consistently decelerating over the year.

V. Monetary Policy Developments

The BSP maintains monetary policy settings during the quarter



During its monetary policy meetings on 12 November and 17 December, the BSP decided to maintain its key policy interest rates at 4.0 percent for the overnight borrowing or RRP facility and 6.0 percent for the overnight lending or RP facility. The interest rates on term RRPs, RPs, and SDAs were also kept steady. Similarly, the reserve requirement ratios were left unchanged.

The policy decisions were based on the BSP's assessment of the dynamics and risks in the inflation environment over the policy horizon. Latest baseline forecasts show that inflation would likely settle below the inflation target range of 3 percent ± 1 percentage point for 2015 due to low inflation readings. However, inflation is projected to return gradually to a path consistent with the inflation target for 2016-2017, as the effects of recent weather disturbances continue to be felt. Meanwhile, inflation expectations remain firmly anchored within the inflation target band for 2016 and 2017.

The BSP likewise noted that the risks to the inflation outlook continued to be broadly balanced. Upside risks to inflation could come from the impact of protracted El Niño dry weather conditions on food prices and utility rates as well as pending petitions for power rate adjustments. Meanwhile, downside risks to inflation could emanate from the weakness in the global economy. At the same time, the BSP observed that domestic demand conditions remain firm, supported by solid private household and capital spending, buoyant market sentiment, and adequate domestic liquidity.

In addition, the BSP considered the potential impact of the recent monetary policy adjustment in the US on global financial conditions, noting that keeping monetary policy settings steady for the time being would allow the BSP some room to continue to assess evolving global economic conditions and calibrate its policy tools as necessary.

VI. INFLATION OUTLOOK

BSP Inflation Forecasts [72]

Results of the latest BSP forecasting exercise indicate that inflation could return gradually to a target-consistent path over the policy horizon

The latest BSP baseline forecasts show that inflation could approach the midpoint of the target range in 2016 – 2017. The inflation projection for 2016 is lower compared to the previous quarter's forecast due mainly to lower global crude oil prices. Meanwhile, the slightly higher inflation forecast for 2017 reflected a weaker peso. Over the next two years, inflation is expected to generally hover around the midpoint of the target range of 3.0 percent ± 1.0 ppt.

Demand Conditions

Outturns for key demand indicators attest to the view of firm underlying momentum in real sector activity. The domestic economy accelerated to post a 6.0-percent expansion in Q3 2015 from 5.8 percent in the previous quarter. Domestic economic activity was driven mainly by steady private consumption, higher capital formation and marked improvement in government spending. This brought average growth to 5.6 percent for the first three quarters of the year.

Other real sector indicators support the view of a robust domestic economy. More than half of all major manufacturing sectors continued to operate above 80 percent of their capacity. The composite PMI remains above the 50-point mark at 57.2 in November 2015. There have also been improvements in labor market conditions with the unemployment rate lower compared to a year ago, based on the results of the October 2015 Labor Force Survey (LFS).

The optimistic outlook for real economic activity has also been reflected in the results of the BSP expectations surveys, which showed buoyant sentiment by both businesses and households. In particular, both households' and firms' expectations for Q4 2015 are upbeat, broadly in

[72] The inflation forecast path in this report refers to the forecasts presented during the 17 December 2015 Monetary Policy Meeting. In the discussion, these forecasts are compared to the forecasts presented in the Q3 Inflation Report (or the forecasts during the 24 September 2015 Monetary Policy Meeting).

line with the brisker operations during the holiday season and the generally favorable macroeconomic conditions.

Supply Conditions

Favorable supply prospects point to manageable inflation environment over the policy horizon

Commodity prices are likely to remain subdued, reflecting ample supply conditions. Food inflation is likely to remain benign over the near term given prospects of good harvest of key agricultural commodities. However, a strengthening of the ongoing *El Niño* weather disturbance could adversely affect production, potentially translating to higher food prices. Similarly, international oil prices are likely to remain below 2014 levels as suggested by futures prices of oil and forecasts by multilateral agencies, with modest gains over the medium term.

Global agricultural prices declined in 2015 and could remain at moderate levels over the medium term. Forecasts by the IMF and the World Bank suggest a continued decline in benchmark prices of key grains (wheat, maize, and rice) in 2016. Despite the ongoing *El Niño* weather phenomenon, ample supply should keep food price pressures at bay.

In the domestic front, fourth quarter *palay* and corn production could decline by 1.8 percent and 4.2 percent, respectively, due primarily to insufficient water supply, adverse effects of typhoon *Lando*, and dry spells brought about by the *El Niño* weather condition.[73] Meanwhile, *palay* and corn production in Q1 2016 could increase slightly by 0.3 percent and 0.5 percent, respectively, based on farmers' planting intentions.

The intensifying *El Niño* levels, which could last until 1H of 2016, could lead to moderate to severe drought conditions over the period. The latest assessment of the Philippine Atmospheric, Geophysical and Astronomical Services Administration (PAGASA) showed that slightly warmer average temperature and significant reduction in rainfall could result in moderate to severe drought conditions over the forecast

[73] PSA, *Rice and Corn Situation Outlook,* October 2015, available online at http://www.agstat.psa.gov.ph

horizon. Stronger *El Niño* conditions could provide upside pressures on the prices of agricultural commodities and utilities.

However, to help mitigate the impact of *El Niño* on agricultural production, the Department of Agriculture (DA) has activated its National *El Niño* Task Force to coordinate the various response measures. These programs include cloud seeding operations, installation of alterative irrigation systems, crop rotation, the use of hybrid crop varieties, and other government assistance for farmers. At the same time, the national government is expected to import additional rice supply for 2016 in response to the production losses from typhoon *Lando*.

Similarly, international oil prices have decreased compared to the previous quarter's level. The decline in crude oil prices could be traced to a combination of ample supply, sluggish demand, and a strong dollar.

Looking ahead, futures prices of oil as well as forecasts by multilateral agencies suggest that oil prices are likely to remain below 2014 levels. Forecast by the EIA suggests that Brent crude oil price could average to US$56.24 per barrel in 2016. Meanwhile, IMF and World Bank expect crude oil prices to average at US$59.56 per barrel and US$51.40 per barrel in 2016, respectively. There is, however, substantial uncertainty in the oil price outlook with concerns over the re-entry of Iran in the export market, the strength of oil consumption growth, and the responsiveness of non-OPEC production to the current low prices.[74,75]

Output gap estimate narrows

The balance of demand and supply conditions as captured by the output gap (or the difference between actual and potential output), provides an indication of potential inflationary pressures in the near term. [76]

Given the latest GDP data, preliminary estimates by the BSP show a lower positive output gap in

[74] IMF, *Commodity Price Outlook and Risks*, 11 November 2015, available online at http://www.imf.org
[75] EIA, *Short-Term Energy Outlook*, 10 November 2015, available online at http://www.eia.gov
[76] Inflation tends to rise (fall) when demand for goods and services exert pressure on the economy's ability to produce goods and services, i.e., when the output gap is positive (negative).

Q3 2015 relative to the previous quarter. The output gap narrowed as the q-o-q expansion in estimated potential output outpaced actual output growth during the review period.[77]

Key assumptions used to generate the BSP's inflation forecasts

The BSP's baseline inflation forecasts generated from the BSP's single equation model (SEM) and the multi-equation model (MEM) are based on the following assumptions:

1) BSP's overnight RRP rate at 4.00 percent from December 2015 to December 2017;

2) BSP's reserve requirement at 20.0 percent from December 2015 to December 2017;

3) NG fiscal deficits for 2015 to 2017, which are consistent with the DBCC-approved estimates;

4) Dubai crude oil price assumptions, the trend of which is consistent with the trend of futures prices of oil in the international market;

5) Increase in nominal wage of 5.6 percent in July 2016 and July 2017;

6) Real GDP growth is endogenously determined in the BSP's MEM; and

7) Foreign exchange rate is endogenously determined in the BSP's MEM through the purchasing power parity and interest rate parity relationships.

[77] Based on the seasonally-adjusted GDP growth

Risks to the Inflation Outlook

Compared with the previous report, the latest projected inflation path is lower for 2016, but slightly higher for 2017

The risks to the inflation outlook may be presented graphically through a fan chart. The fan chart depicts the probability of different inflation outcomes based on the central projection (corresponding to the baseline forecast of the BSP) and the risks surrounding the inflation outlook.

Compared to the previous inflation report, the latest fan chart presents a downward shift in the inflation projections for 2016 and a slightly higher path for 2017. The reduction in the inflation projections for 2016 reflected the continued decline in global crude oil prices. Meanwhile, the inflation forecasts for 2017 increased due to the projected depreciation of the peso.

Upside risks could come from the impact of prolonged El Niño dry weather conditions on food prices and utility rates as well as pending petitions for power rate adjustments, while the downside risk could arise from ongoing weakness in the global economy

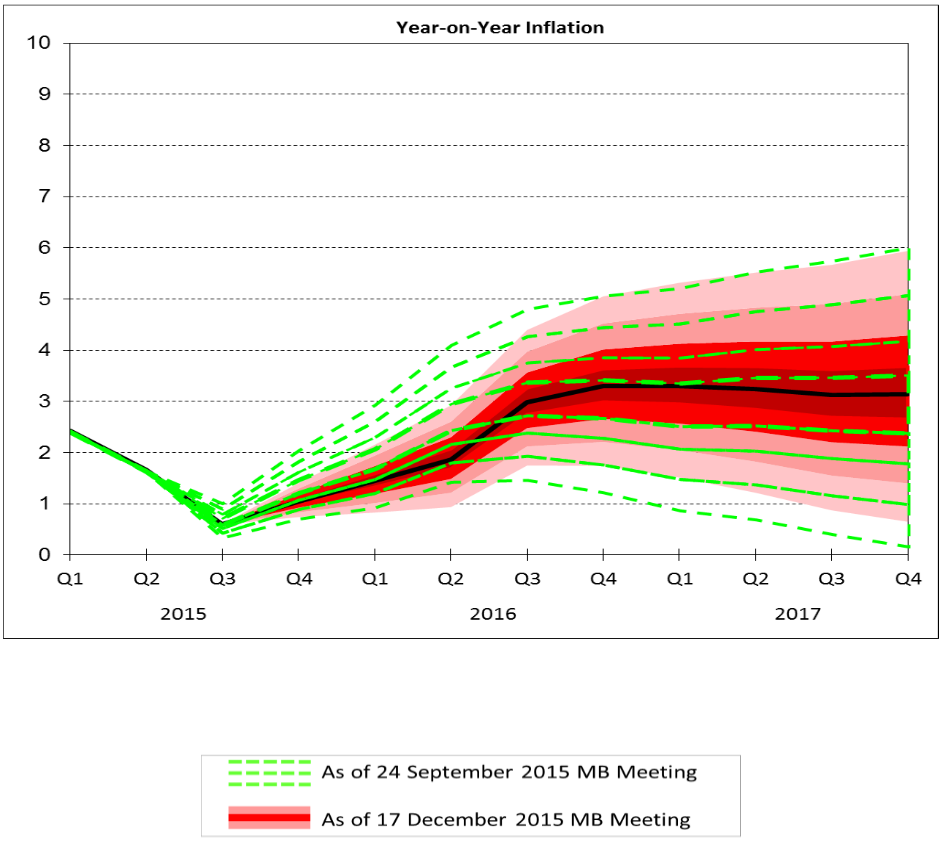
The BSP's review of current price trends suggests that there are risks surrounding the inflation outlook. This assessment is captured in the latest fan chart by the projected bands above and below the central projection.

Pending petitions for power rate adjustments and the impact of prolonged *El Niño* dry weather conditions on food prices and utility rates represent upside risks to inflation. Meanwhile, the ongoing weakness in the global economy could provide downside risk to inflation.

The occurrence of stronger-than-expected *El Niño* weather disturbance could adversely affect domestic food production as well as power and water supply. The said weather condition is expected to manifest as both drier-than-normal weather conditions and stronger-than-usual typhoons, which could impact negatively the planting season, ultimately posing a risk to food prices. Similarly, the *El Niño* weather phenomenon could lower the output of hydro-powered generation plants and consequently raise the cost of electricity and water.

The pending petition of Meralco on the December 2013 rate adjustment, which is still under the temporary restraining order of the Supreme Court, also continues to pose an upside risk to the inflation outlook.

Meanwhile, the possibility of a slower global economic growth could imply weaker demand-related price pressures as well as further uncertainties in the global oil market. The rebalancing in China, further decline in commodity prices, higher foreign currency exposure of corporate balance sheets, and capital flow reversals due to disruptive asset price shifts related to the normalization in US Fed policy rates are potential sources of downside risks to global growth prospects.



The fan chart shows the probability of various outcomes for inflation over the forecast horizon. The darkest band depicts the central projection, which corresponds to the BSP's baseline inflation forecast. It covers 25 percent of the probability distribution. Each successive pair of bands is drawn to cover a further 25 percent of probability, until 75 percent of the probability distribution is covered. Lastly, the lightest band covers the lower and upper 90 percent of the probability distribution. The bands widen (i.e., "fan out") as the time frame is extended, indicating increasing uncertainty about outcomes. The band in wire mesh depicts the inflation profile in the previous report.

VII. IMPLICATIONS FOR THE MONETARY POLICY STANCE

The average headline inflation is projected to return gradually to the inflation target range over the policy horizon

The latest baseline inflation forecasts show that inflation could move close to the 3.0 percent ± 1.0 ppt inflation target range for 2016-2017. The downward shift in the forecasted inflation path for 2016 is due mainly to lower global crude oil prices. Meanwhile, the slightly higher inflation forecast for 2017 reflected a weaker peso.

Potential adjustments in electricity rates given pending petitions and the impact of prolonged *El Niño* dry weather conditions are seen as the key upside risks to inflation. Meanwhile, the ongoing weakness in the global economy could provide downside risk to inflation.

Inflation expectations remain well-anchored over the policy horizon. Consistent with the BSP's inflation outlook, mean inflation forecasts based on December 2015 surveys of private sector economists have remained within the inflation target range in 2016-2017 while settling below the lower bound of the target range for 2015.

Inflation gains momentum

Headline inflation averaged higher in Q4 2015 at 1.0 percent from 0.6 percent in the previous quarter as prices of some food items went up due to decreasing supply caused by the recent typhoons that visited the country. Likewise, non-food inflation edged higher as prices of service-related CPI components accelerated during the quarter.

Domestic demand conditions remain firm

The Philippine economy grew by 6.0 percent in the third quarter, an improvement from the 5.8 percent growth in the previous quarter and from 5.5 percent in Q3 2014. This brought year-to-date growth to 5.6 percent, albeit still below the government's growth target of 7-8 percent. Strong domestic demand fueled output growth, led by significant improvement in government spending, solid household consumption, and higher capital formation. On the supply side, growth was driven by the services sector while growth in the industry sector was supported by manufacturing.

Consistent with these developments, other indicators continue to point to positive growth momentum. Business outlook on the economy turned more upbeat for Q4 2015, with the overall confidence index (CI) rising to 51.3 percent—the highest in two years. Business outlook also remain positive for Q1 2016 at 43.9 percent albeit lower due to the typical slowdown in demand after the holiday season, concerns over the adverse effects of El Niño, and uncertainties in the global economy. Meanwhile, consumers' outlook improved for Q4 2015 as the overall confidence index (CI) turned less negative (from -11.6 percent to -8.1 percent) for Q3 2015. For the next quarter (Q1 2016), consumers' optimism was sustained as the CI was broadly steady while sentiment was more favorable for the next 12 months.

Prospects across the globe remain uneven

Growth in the US economy holds firm while economic activity in the euro area strengthen. However, downturn in key emerging markets, such as Brazil, China, and Russia, continues. Meanwhile, a number of central banks ease their monetary policy settings in Q4 2015 to support domestic economic activity and stave off delfationary pressures, while the US Fed decides to raise interest rates.

Current monetary policy settings remain appropriate

Notwithstanding below-target inflation for 2015, inflation dynamics are expected to gather some momentum in 2016 but will remain manageable given well-contained inflation expectations over the policy horizon. Moreover, latest baseline inflation forecasts extending to 2017 show that annual average inflation is likely to settle within the target range. This outlook serves as the key argument for maintaining the BSP's monetary policy settings.

At the same time, firm demand-side conditions suggest that current monetary policy settings are appropriately calibrated with minimal deflationary risks. Thus, the economy does not need further monetary stimulus given the still ample liquidity in the system, sustained credit expansion and increased fiscal spending. Keeping a steady hand on policy levers remains prudent given the challenging global economic environment and to better gauge the impact of the US Fed normalization. Over the period ahead, emerging market economies (EMEs) could face the challenge of potential capital flow reversals and renewed volatility in financial markets. Keeping policy settings unchanged will allow authorities to consider further information on economic and financial conditions, and provide flexibility in responding to future monetary policy challenges resulting from the critical early stages of policy normalization in the US.

On balance, the BSP is of the view that current monetary policy settings remain appropriately calibrated. Going forward, the BSP will continue to monitor domestic and external developments to ensure that the monetary policy stance remains consistent with its price and financial stability objectives.

SUMMARY OF MONETARY POLICY DECISIONS

EFFECTIVITY DATE		LEVELS (IN %)		MONETARY POLICY DECISION
		RRP OVERNIGHT	RP OVERNIGHT	
2008	**JAN 31**	5.00	7.00	The Monetary Board (MB) decided to reduce by 25 basis points (bps) the BSP's key policy interest rates to 5 percent for the overnight borrowing or reverse repurchase (RRP) facility and 7 percent for the overnight lending or repurchase (RP) facility. The interest rates on term RRPs, RPs, and special deposit accounts (SDAs) were also reduced accordingly. In its assessment of macroeconomic conditions, the MB noted that the latest inflation forecasts indicated that inflation would fall within the 4.0 percent ± 1 percentage point target range in 2008 and the 3.5 ± 1 percentage point target range in 2009.
	MAR 13	5.00	7.00	The MB decided to keep the BSP's key policy interest rates at 5 percent for the overnight borrowing or RRP facility and 7 percent for the overnight lending or RP facility. The MB also decided to implement immediately the following refinements in the SDA facility: (1) the closure of existing windows for the two-, three-, and six-month tenors; and (2) the reduction of the interest rates on the remaining tenors. The interest rates on term RRPs and RPs were also left unchanged.
	APR 24	5.00	7.00	The MB kept the BSP's key policy interest rates at 5.0 percent for the overnight borrowing or RRP facility and 7.0 percent for the overnight lending or RP facility. The interest rates on term RRPs and RPs were also left unchanged.
	JUN 5	5.25	7.25	The MB decided to increase by 25 bps the BSP's key policy interest rates to 5.25 percent for the RRP facility and 7.25 percent for RP facility as emerging baseline forecasts indicate a likely breach of the inflation target for 2008 along with indications that supply-driven pressures are beginning to feed into demand. Given the early evidence of second-round effects, the MB recognized the need to act promptly to rein in inflationary expectations. The interest rates on term RRPs, RPs, and SDAs were also increased accordingly.
	JUL 17	5.75	7.75	The MB increased by 50 bps the BSP's key policy interest rates to 5.75 percent for the overnight borrowing or RRP facility and 7.75 percent for the overnight lending or RP facility. The interest rates on term RRPs, RPs, and SDAs were also increased accordingly.
	AUG 28	6.00	8.00	The MB increased by 25 bps the BSP's key policy interest rates to 6.0 percent for the overnight borrowing or reverse repurchase (RRP) facility and 8.0 percent for the overnight lending or repurchase (RP) facility. The interest rates on term RRPs, RPs, and SDAs were also increased accordingly.

Effectivity Date		Levels (in %)		Monetary Policy Decision
		RRP Overnight	RP Overnight	
2008	**Oct 6**	6.00	8.00	The MB kept the BSP's key policy interest rates unchanged at 6.0 percent for RRP facility and 8.0 percent for the RP facility. The interest rates on term RRPs, RPs, and SDAs were also left unchanged.
	Nov 6	6.00	8.00	The MB decided to keep the BSP's key policy interest rates steady at 6 percent for the overnight borrowing or RRP facility and 8 percent for the overnight lending or RP facility. The interest rates on term RRPs, RPs, and SDAs were also left unchanged.
	Dec 18	5.50	7.50	The MB decided to reduce the BSP's key policy interest rates by 50 bps to 5.5 percent for the overnight borrowing or RRP facility and 7.5 percent for the overnight lending or RP facility. The interest rates on term RRPs, RPs, and SDAs were also adjusted accordingly. Latest baseline forecasts showed a decelerating inflation path over the policy horizon, with inflation falling within target by 2010. This outlook is supported by the downward shift in the balance of risks, following the easing of commodity prices, the moderation in inflation expectations, and the expected slowdown in economic activity.
2009	**Jan 29**	5.00	7.00	The MB decided to reduce the BSP's key policy interest rates by another 50 bps to 5 percent for the overnight borrowing or RRP facility and 7 percent for the overnight lending or RP facility. The interest rates on term RRPs, RPs, and SDAs were also adjusted accordingly. Latest baseline forecasts showed a decelerating inflation path over the policy horizon, with inflation falling within target by 2010. The MB based its decision on the latest inflation outlook which shows inflation falling within the target range for 2009 and 2010. The Board noted that the balance of risks to inflation is tilted to the downside due to the softening prices of commodities, the slowdown in core inflation, significantly lower inflation expectations, and moderating demand.
	Mar 5	4.75	6.75	The MB decided to reduce the BSP's key policy interest rates by 25 bps to 4.75 percent for the overnight borrowing or RRP facility and 6.75 percent for the overnight lending or RP facility. The interest rates on term RRPs, RPs, and SDAs were also reduced accordingly. Given possible upside risks to inflation, notably the volatility in oil prices and in exchange rates, increases in utility rates, and potential price pressures coming from some agricultural commodities, the MB decided that a more measured adjustment of policy rates was needed.

Effectivity Date		Levels (in %)		Monetary Policy Decision
		RRP Overnight	RP Overnight	
2008	**Apr 16**	4.50	6.50	The MB reduced key policy rates by another 25 bps to 4.5 percent for the overnight borrowing or RRP facility and 6.5 percent for the overnight lending or RP facility, effective immediately. This rate cut brings the cumulative reduction in the BSP's key policy rates to 150 bps since December last year. The current RRP rate is the lowest since 15 May 1992. Meanwhile, the interest rates on term RRPs, RPs, and SDAs were also reduced accordingly. In its assessment of macroeconomic conditions, the MB noted that the latest baseline inflation forecasts indicated a lower inflation path over the policy horizon, with average inflation expected to settle within the target ranges in 2009 and 2010. In addition, the MB considered that the risks to inflation are skewed to the downside given expectations of weaker global and domestic demand conditions and a low probability of a significant near-term recovery in commodity prices.
2009	**May 28**	4.25	6.25	The MB decided to reduce the BSP's key policy interest rates by another 25 bps to 4.25 percent for the overnight borrowing or RRP facility and 6.25 percent for the overnight lending or RP facility. The interest rates on term RRPs, RPs, and SDAs were also reduced accordingly. Baseline forecasts indicated a lower inflation path over the policy horizon, with average inflation expected to settle within the target ranges in 2009 and 2010. In addition, the Monetary Board considered that, on balance, the risks to inflation are skewed to the downside given expectations of weaker global and domestic demand conditions and a low probability of a significant near-term recovery in commodity prices.
	Jul 9	4.00	6.00	The MB decided to reduce the BSP's key policy interest rates by 25 bps to 4 percent for the overnight borrowing or RRP facility and 6 percent for the overnight lending or RP facility, effective immediately. The interest rates on term RRPs, RPs, and SDAs were reduced accordingly. This is the sixth time since December 2008 that the BSP has cut its policy interest rates.
	Aug 20 **Oct 1** **Nov 5** **Dec 17**	4.00	6.00	The MB kept key policy rates unchanged at 4 percent for the RRP facility and 6 percent for the overnight lending RP facility. The decision to maintain the monetary policy stance comes after a series of policy rate cuts since December 2008 totaling 200 bps and other liquidity enhancing measures.

Effectivity Date		Levels (in %)		Monetary Policy Decision
		RRP Overnight	RP Overnight	
2010	Jan 28 Mar 11 Apr 22 Jun 3 Jul 15 Aug 26 Oct 7 Nov 18 Dec 29	4.00	6.00	The MB decided to keep the BSP's key policy interest rates steady at 4 percent for the RRP facility and 6 percent for the RP facility. The interest rates on term RRPs, RPs, and SDAs were also left unchanged.
2011	Feb 10	4.00	6.00	The MB decided to keep the BSP's key policy interest rates steady at 4 percent for the overnight borrowing or RRP facility and 6 percent for the overnight lending or RP facility. The interest rates on term RRPs, RPs, and SDAs were also left unchanged.
	Mar 24	4.25	6.25	The MB decided to increase by 25 bps the BSP's key policy interest rates to 4.25 percent for the overnight borrowing or RRP facility and 6.25 percent for the overnight lending or RP facility. The interest rates on term RRPs, RPs, and SDAs were also raised accordingly. The MB's decision was based on signs of stronger and broadening inflation pressures as well as a further upward shift in the balance of inflation risks. International food and oil prices have continued to escalate due to the combination of sustained strong global demand and supply disruptions and constraints.
	May 5	4.50	6.50	The MB decided to increase the BSP's key policy interest rates by another 25 bps to 4.5 percent for the overnight borrowing or RRP facility and 6.5 percent for the overnight lending or RP facility. The interest rates on term RRPs, RPs, and SDAs were also raised accordingly. Baseline inflation forecasts continue to suggest that the 3-5 percent inflation target for 2011 remains at risk, mainly as a result of expected pressures from oil prices.
	Jun 16	4.50	6.50	The MB decided to keep policy rates steady at 4.5 percent for the overnight borrowing or RRP facility and 6.5 percent for the overnight lending or RP facility. At the same time, the Board decided to raise the reserve requirement on deposits and deposit substitutes of all banks and non-banks with quasi-banking functions by one percentage point effective on Friday, 24 June 2011. The MB's decision to raise the reserve requirement is a preemptive move to counter any additional inflationary pressures from excess liquidity.

Effectivity Date		Levels (in %)		Monetary Policy Decision
		RRP Overnight	RP Overnight	
2011	**Jul 28**	4.50	6.50	The MB maintained the BSP's key policy interest rates at 4.5 percent for the overnight borrowing or RRP facility and 6.5 percent for the overnight lending or RP facility. At the same time, the Board increased anew the reserve requirement on deposits and deposit substitutes of all banks and non-banks with quasi-banking functions by one percentage point effective on 5 August 2011. The MB's decision to raise the reserve requirement anew is a forward-looking move to better manage liquidity.
	Sep 8 **Oct 20** **Dec 1**	4.50	6.50	The MB decided to keep the overnight policy rates steady. At the same time, the reserve requirement ratios were kept unchanged.
2012	**Jan 19**	4.25	6.25	The MB decided to reduce the BSP's key policy interest rates by 25 bps to 4.25 percent for the overnight borrowing or RRP facility and 6.25 percent for the overnight lending or RP facility. The interest rates on term RRPs, RPs, and SDAs were also reduced accordingly The MB's decision is based on its assessment that the inflation outlook remains comfortably within the target range, with expectations well-anchored and as such, allowed some scope for a reduction in policy rates to help boost economic activity and support market confidence.
	Mar 1	4.00	6.00	The MB decided to reduce the BSP's key policy interest rates by another 25 bps to 4.0 percent for the overnight borrowing or RRP facility and 6.0 percent for the overnight lending or RP facility. The interest rates on term RRPs, RPs, and SDAs were also reduced accordingly. The MB is of the view that the benign inflation outlook has allowed further scope for a measured reduction in policy rates to support economic activity and reinforce confidence.
	Apr 19	4.00	6.00	The MB decided to keep the BSP's key policy interest rates steady at 4 percent for the overnight borrowing or RRP facility and 6 percent for the overnight lending or RP facility. The interest rates on term RRPs, RPs, and SDAs were also left unchanged.
2012	**Jun 14**	4.00	6.00	The MB decided to keep the BSP's key policy interest rates steady at 4 percent for the overnight borrowing or RRP facility and 6 percent for the overnight lending or RP facility. The interest rates on term RRPs, RPs, and SDAs were also left unchanged. The MB's decision was based on its assessment that the inflation environment remains manageable. Baseline forecasts continue to track the lower half of the 3-5 percent target range for 2012 and 2013, while inflation expectations remain firmly anchored. At the same time, domestic macroeconomic readings have improved significantly in Q1 2012.

Effectivity Date		Levels (in %)		Monetary Policy Decision
		RRP Overnight	RP Overnight	
2012	**Jul 26**	3.75	5.75	The MB decided to reduce the BSP's key policy interest rates by 25 bps to 3.75 percent for the overnight borrowing or RRP facility and 5.75 percent for the overnight lending or RP facility. The interest rates on term RRPs, RPs, and SDAs were also reduced accordingly. This is the third time in 2012 that the BSP has cut its policy rates. The MB's decision was based on its assessment that price pressures have been receding, with risks to the inflation outlook slightly skewed to the downside. Baseline forecasts indicate that inflation is likely to settle within the lower half of the 3-5 percent target for 2012 and 2013, as pressures on global commodity prices are seen to continue to abate amid weaker global growth prospects. At the same time, the MB is of the view that prospects for global economic activity are likely to remain weak.
	Sep 13	3.75	5.75	The MB decided to keep the BSP's key policy interest rates steady at 3.75 percent for the overnight borrowing or RRP facility and 5.75 percent for the overnight lending or RP facility. The interest rates on term RRPs, RPs, and SDAs were also left unchanged. The MB's decision was based on its assessment that the inflation environment remains benign, with the risks to the inflation outlook appearing to be broadly balanced.
	Oct 25	3.50	5.50	The MB decided to reduce the BSP's key policy interest rates by 25 bps to 3.50 percent for the overnight borrowing or RRP facility and 5.50 percent for the overnight lending or RP facility. The interest rates on term RRPs, RPs, and SDAs were also reduced accordingly. This is the fourth time in 2012 that the BSP has cut its policy rates. The MB's decision was based on its assessment that the inflation environment continued to be benign with latest baseline forecasts indicating that the future inflation path will remain within target for 2012-2014. A rate cut would also be consistent with a symmetric response to the risk of below-target inflation.
2012	**Dec 13**	3.50	5.50	The MB decided to keep the BSP's key policy interest rates steady at 3.50 percent for the overnight borrowing or RRP facility and 5.50 percent for the overnight lending or RP facility. The interest rates on term RRPs, RPs, and SDAs were also left unchanged. The MB's decision was based on its assessment that current monetary settings remained appropriate, as the cumulative 100-basis-point reduction in policy rates in 2012 continued to work its way through the economy.

Effectivity Date		Levels (in %)		Monetary Policy Decision
		RRP Overnight	RP Overnight	
2013	Jan 24	3.50	5.50	The MB decided to keep the BSP's key policy interest rates steady at 3.50 percent for the overnight borrowing or RRP facility and 5.50 percent for the overnight lending or RP facility. The interest rates on term RRPs and RPs were also maintained accordingly. The reserve requirement ratios were kept steady as well. At the same time, the MB decided to set the interest rates on the SDA facility at 3.00 percent regardless of tenor, effective immediately, consistent with the BSP's continuing efforts to fine-tune the operation of its monetary policy tools.
	Mar 14	3.50	5.50	The MB decided to keep the BSP's key policy interest rates steady at 3.50 percent for the overnight borrowing or RRP facility and 5.50 percent for the overnight lending or RP facility. The interest rate on the RRP was also set at 3.50 percent regardless of tenor. Following its previous decision to rationalize the SDA facility in January 2013, the MB further reduced the interest rates on the SDA facility by 50 bps to 2.50 percent across all tenors effective immediately.
	Apr 25	3.50	5.50	The MB decided to keep the BSP's key policy interest rates steady at 3.50 percent for the overnight borrowing or RRP facility and 5.50 percent for the overnight lending or RP facility. The interest rate on the RRP was also set at 3.50 percent regardless of tenor. Meanwhile, the SDA rate was further reduced by 50 basis points to 2.0 percent across all tenors.
	Jun 13	3.50	5.50	The MB decided to keep the BSP's key policy interest rates steady at 3.50 percent for the overnight borrowing or RRP facility and 5.50 percent for the overnight lending or RP facility. The interest rates on term RRPs, RPs, and SDA were also maintained.
	Jul 25	3.50	5.50	The MB decided to keep the BSP's key policy interest rates steady at 3.50 percent for the overnight borrowing or RRP facility and 5.50 percent for the overnight lending or RP facility. The interest rates on term RRPs, RPs, and SDA were also maintained.
	Sep 12	3.50	5.50	The MB decided to keep the BSP's key policy interest rates steady at 3.50 percent for the overnight borrowing or RRP facility and 5.50 percent for the overnight lending or RP facility. The interest rates on term RRPs, RPs, and SDA were also maintained.
	Oct 24	3.50	5.50	The MB decided to keep the BSP's key policy interest rates steady at 3.50 percent for the overnight borrowing or RRP facility and 5.50 percent for the overnight lending or RP facility. The interest rates on term RRPs, RPs, and SDA were also maintained.

Effectivity Date		Levels (in %)		Monetary Policy Decision
		RRP Overnight	RP Overnight	
2013	**Dec 12**	3.50	5.50	The MB decided to keep the BSP's key policy interest rates steady at 3.50 percent for the overnight borrowing or RRP facility and 5.50 percent for the overnight lending or RP facility. The interest rates on term RRPs, RPs, and SDA were also maintained.
2014	**Feb 6**	3.50	5.50	The MB decided to keep the BSP's key policy interest rates steady at 3.50 percent for the overnight borrowing or RRP facility and 5.50 percent for the overnight lending or RP facility. The interest rates on term RRPs, RPs, and SDA were also maintained.
	Mar 27	3.50	5.50	The MB decided to keep the BSP's key policy interest rates steady at 3.50 percent for the overnight borrowing or RRP facility and 5.50 percent for the overnight lending or RP facility. The interest rates on term RRPs, RPs, and SDA were also maintained. Meanwhile, the MB decided to increase the reserve requirement by one percentage point effective on 11 April 2014.
	May 8	3.50	5.50	The MB decided to keep the BSP's key policy interest rates steady at 3.50 percent for the overnight borrowing or RRP facility and 5.50 percent for the overnight lending or RP facility. The interest rates on term RRPs, RPs, and SDA were also maintained. Meanwhile, the MB decided to increase the reserve requirements for U/KBs and TBs by a further one percentage point effective on 30 May 2014.
	Jun 19	3.50	5.50	The MB decided to keep the BSP's key policy interest rates steady at 3.50 percent for the overnight borrowing or RRP facility and 5.50 percent for the overnight lending or RP facility. The interest rates on term RRPs and RPs were also maintained. The reserve requirement ratios were left unchanged as well. Meanwhile, the MB decided to raise the interest rate on the SDA facility by 25 basis points from 2.0 percent to 2.25 percent across all tenors effective immediately.
	Jul 31	3.75	5.75	The MB decided to increase the BSP's key policy rates by 25 bps to 3.75 percent for the overnight borrowing or RRP facility and 5.75 percent for the overnight lending or RP facility. The interest rates on term RRPs and RPs were also raised accordingly. The rate on special deposit accounts (SDA) was left unchanged. Meanwhile, the reserve requirement ratios were also kept steady.
	Sep 11	4.00	6.00	The MB decided to increase the BSP's key policy rates by 25 bps to 4.0 percent for the overnight borrowing or RRP facility and 6.0 percent for the overnight lending or RP facility. The interest rates on term RRPs, RPs, and SDA were also raised accordingly. Meanwhile, the reserve requirement ratios were left unchanged.

Effectivity Date		Levels (in %)		Monetary Policy Decision
		RRP Overnight	RP Overnight	
2014	**Oct 23**	4.00	6.00	The MB decided to maintain the BSP's key policy interest rates at 4.0 percent for the overnight borrowing or reverse repurchase (RRP) facility and 6.0 percent for the overnight lending or repurchase (RP) facility. The interest rates on term RRPs, RPs, and special deposit accounts were also kept steady. The reserve requirement ratios were left unchanged as well.
	Dec 11	4.00	6.00	The MB decided to maintain the BSP's key policy interest rates at 4.0 percent for the overnight borrowing or reverse repurchase (RRP) facility and 6.0 percent for the overnight lending or repurchase (RP) facility. The interest rates on term RRPs, RPs, and special deposit accounts were also kept steady. The reserve requirement ratios were left unchanged as well.
2015	**Feb 12** **Mar 26** **May 14** **Jun 25** **Aug 13** **Sep 24** **Nov 12** **Dec 17**	4.00	6.00	The MB decided to maintain the BSP's key policy interest rates at 4.0 percent for the overnight borrowing or reverse repurchase (RRP) facility and 6.0 percent for the overnight lending or repurchase (RP) facility. The interest rates on term RRPs, RPs, and special deposit accounts were also kept steady. The reserve requirement ratios were left unchanged as well.

The *BSP Inflation Report* is published every quarter by the Bangko Sentral ng Pilipinas. The report is available as a complete document in pdf format, together with other general information about inflation targeting and the monetary policy of the BSP, on the BSP's website:

www.bsp.gov.ph/monetary/inflation.asp

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The BSP also welcomes feedback from readers on the contents of the Inflation Report as well as suggestions on how to improve the presentation. Please send comments and suggestions to the following addresses:

By post:	BSP Inflation Report c/o Department of Economic Research Bangko Sentral ng Pilipinas A. Mabini Street, Malate, Manila Philippines 1004
By e-mail:	bspmail@bsp.gov.ph